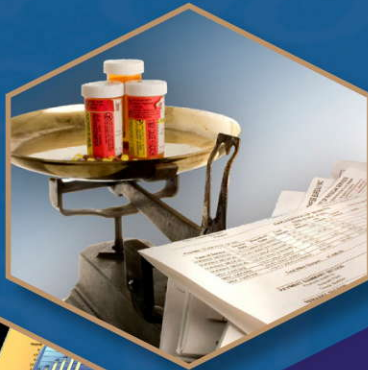


# Southern Conference on Teacher Retirement

Biloxi, Mississippi

May 18, 2011



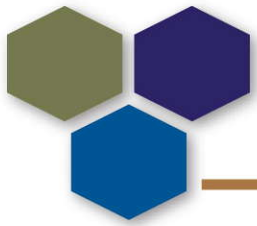
## The GASB Files for Divorce !

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# GRS

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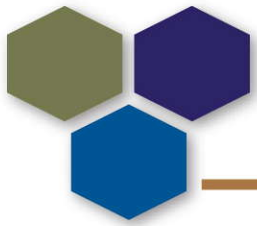
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# *Introduction*

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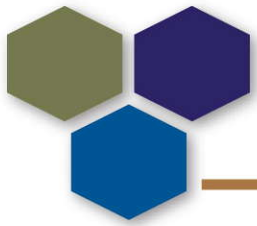
- ◆ The GASB's soon-to-be-released Exposure Drafts on pension accounting
  - ▶ High level discussion only; light on details
  - ▶ Everything in this presentation is tentative
  - ▶ Timetable
    - Exposure drafts (plan and employer) to be issued in June
    - Finals expected to be adopted in June of next year
    - Implementation generally in years ending in 2013 and 2014
- ◆ Accounting and funding have been delinked, decoupled . . . DIVORCED !



## *Outline*

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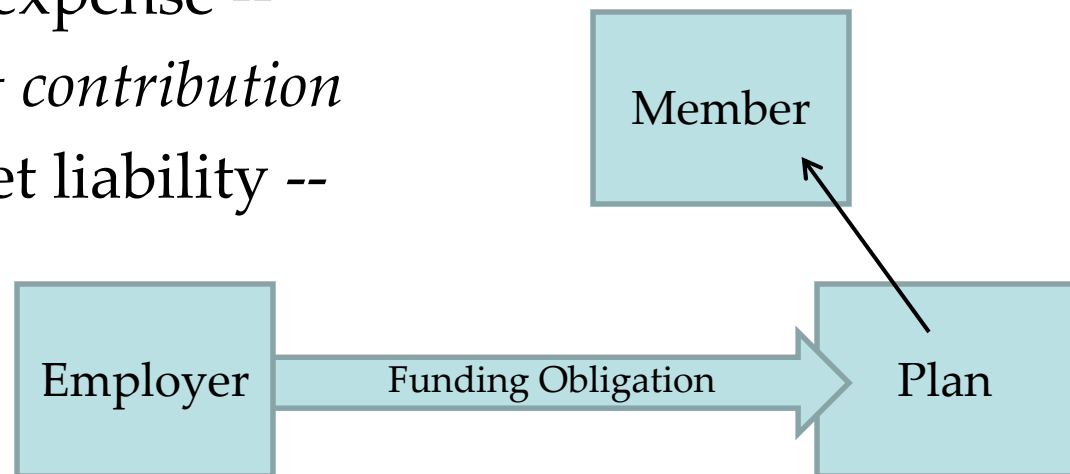
- ◆ The Marriage and the Divorce
- ◆ The Plan's financial statement
- ◆ Implications for Cost-sharing Plans
- ◆ Implementation

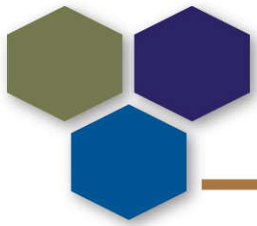


# The Marriage

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- ◆ Accounting and actuarial funding were ONE
- ◆ GASB Statement No. 27
  - ▶ The employer's obligation is to *fund* the plan
  - ▶ The accounting expense -- actuarial *funding contribution*
  - ▶ The balance sheet liability -- *contribution shortfall*

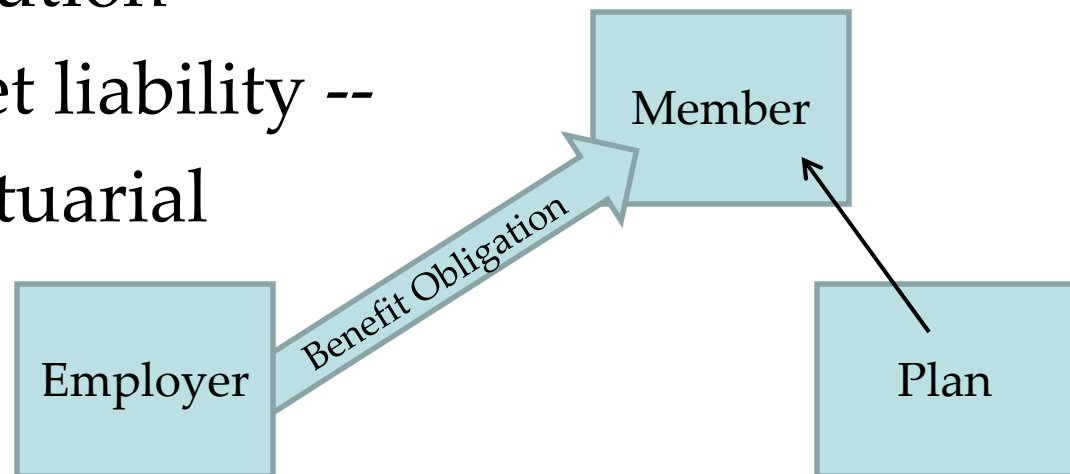


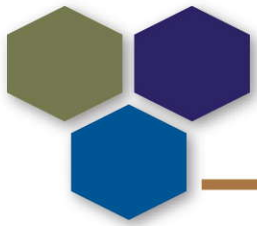


## *The Divorce*

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- ◆ Accounting and actuarial funding will be separate
- ◆ The employer's obligation is "ultimately to the members"
- ◆ The accounting expense -- not be related to any actuarial contribution
- ◆ The balance sheet liability -- the unfunded actuarial accrued liability

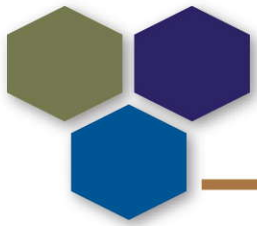




## *The Divorce*

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- ◆ *“We do accounting; actuaries do funding.”* – GASB Board Member
- ◆ Accounting expense will not be viable for funding
  - ▶ Too volatile for funding
  - ▶ Too late for budgeting
- ◆ No more ARC; remove it from your vocabulary
- ◆ Two sets of numbers –
  - ▶ One set for accounting and financial reporting purposes
  - ▶ One set for funding purposes

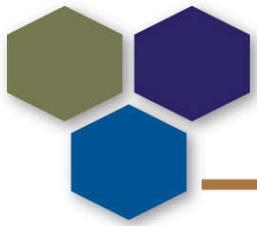


# *The Divorce*

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## ◆ Six Implications

1. A new and very large balance sheet liability
2. Unstable balance sheet liabilities
3. Communication challenges
4. Funding policies re-visited
5. A lot of work
6. Get it right

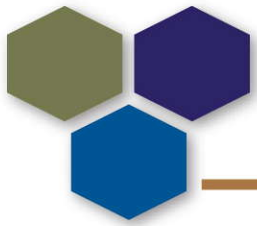


# *The Divorce*

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## ◆ Implications

1. Net Pension Liability (NPL): a new and very large balance sheet liability =
  - ▶ The traditional (not ultimate or replacement life) entry age normal actuarial accrued liability  
minus
  - ▶ The market value of plan net assets



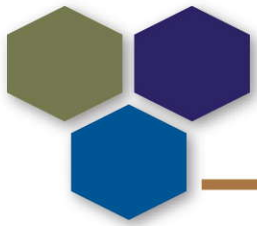
# *The Divorce*

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## ◆ Implications

2. Unstable employer balance sheets . . .

. . . particularly due to the use of the market value of pension plan net assets, instead of a smoothed value



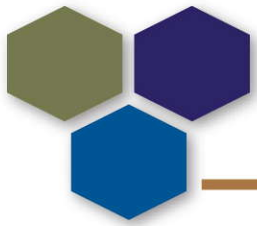
# *The Divorce*

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## ◆ Implications

### 3. Communication challenges . . .

- ▶ With the press, legislators, trustees, participating employers, etc.
- ▶ “So which is the true liability?”
- ▶ “So which is the true expense?”
- ▶ Delete ARC, APC and NPO from our vocabulary
- ▶ Forget *everything* you knew about government pension accounting



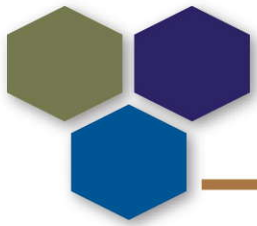
# *The Divorce*

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## ◆ Implications

### 4. Funding policies re-visited

- ▶ Cannot just lean on ARC to set funding level
- ▶ Re-visit fundamental funding policy issues
  - Actuarial cost method
  - Robust, disciplined and well-documented process for setting the long-term expected rate of return
  - Amortization periods and methods
  - Target dates for funded ratios
  - Other related matters such as risk management, etc



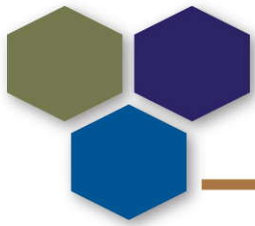
# *The Divorce*

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## ◆ Implications

5. A lot of work

- ▶ For the implementation year
- ▶ For subsequent years



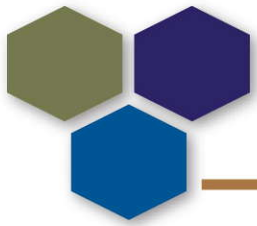
# *The Divorce*

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## ◆ Implications

### 6. Get it right

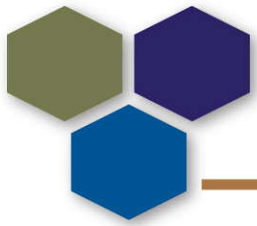
- ▶ SEC is watching
- ▶ Auditors are watching –  
plan's, state's and participating employers'  
auditors
- ▶ GFOA is watching (Certificate of Achievement)
- ▶ Taxpayer watchdog groups are watching
- ▶ The press is watching



## *Plan's Financial Statement*

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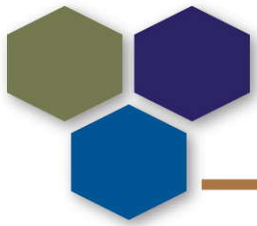
- ◆ Not much change here
  - ▶ More disclosures, based the new Net Pension Liability and the new Pension Expense
- ◆ Almost all the change is in the employers' financial statements



# *Cost-sharing Plans and Employers*

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- ◆ Five major considerations for cost-sharing plans and their participating employers:
  1. Discount rate
  2. Cost method
  3. Allocation to participating employers of various actuarial and accounting totals at the collective plan level
  4. Differing fiscal years
  5. Special funding situations



# *Cost-sharing Plans and Employers*

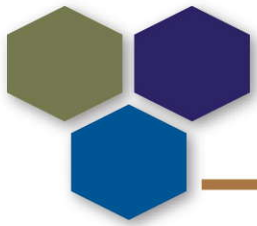
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## 1. Discount rate:

### ▶ Blended rate

- Public Funds Survey says in 2009 only 61% of plans received 90% (or more) of their ARC; down from 90% of plans in 2001
- Some plans' discount rates will lie between their long-term expected rate of return and a long govt borrowing rate
- It will depend on whether their funding policy projects a depletion date

### ▶ Cross-over date

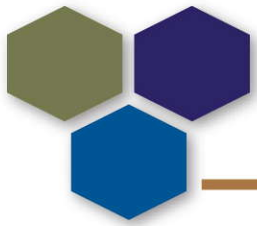


# *Cost-sharing Plans and Employers*

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## 2. Cost method

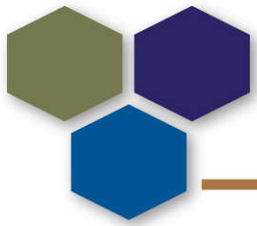
- ▶ *For accounting purposes:* traditional entry age normal actuarial cost method
- ▶ Not the ultimate or replacement life versions of entry age normal
- ▶ A new additional calculation for many plans
- ▶ The GASB does not impose cost methods for funding
- ▶ *For funding purposes,* add a project to your agenda to re-visit funding policy



## *Cost-sharing Plans and Employers*

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3. Allocation to participating employers of actuarial and accounting totals at the collective plan level
  - ▶ Participating employers' financial statements
  - ▶ Parity with sole and agent employers
  - ▶ Allocation of total based on long-term expected contributions of all includable entities
    - E.g., entity's proportionate share of present value of future employer contributions
    - Not based on proportionate share of current year's contribution
  - ▶ This will be a lot of work

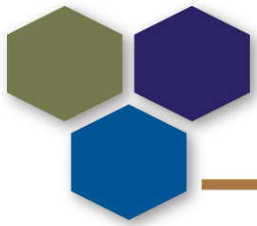


# *Cost-sharing Plans and Employers*

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## 4. Differing fiscal years

- ▶ Participating employers may have different fiscal year ends from the plan
- ▶ Allocated actuarial *cost and liability numbers* can be “rolled forward” or backward to entities’ fiscal years
- ▶ Official auditable *asset numbers* may be required as of each fiscal year for allocation purposes
- ▶ May present challenges for the participating employers’ auditors
- ▶ This will be a lot of work

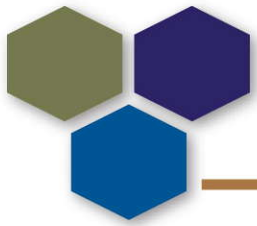


# *Cost-sharing Plans and Employers*

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## 5. Special funding situations

- ▶ Non-employer entities (e.g., the state) with a “legal requirement” to contribute
- ▶ Non-employer entities with no “legal requirement” to contribute; may include:
  - Merely provide funding support or assistance
  - “On behalf of” payments
  - Dedicated sources of revenue (?)
  - Funding history without legal requirement
  - Funding amounts baked into non-employer’s revenue sharing formulas



# *Cost-sharing Plans and Employers*

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## ◆ Implementation

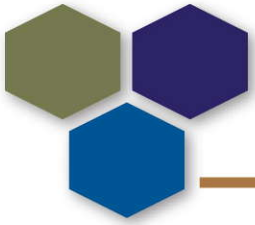
### ▶ Effective dates

- Big soles – years beginning after June 15, 2012
- All others – years beginning after June 15, 2013

### ▶ Retroactive

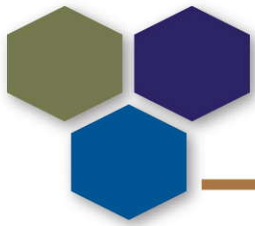
- Restate beginning balances
- To the extent information is available

### ▶ Start preparing soon !



# Acknowledgement

Thank you to Piotr Krekora and Paul Zorn who checked and peer reviewed this presentation.



## *Disclaimers*

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