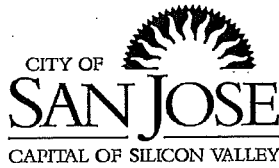


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## Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Sharon W. Erickson,  
City Auditor

Scott P. Johnson,  
Director of Finance

**SUBJECT:** GASB'S PROPOSED FINANCIAL  
REPORTING RULES FOR STATE AND  
LOCAL GOVERNMENT PENSIONS

**DATE:** July 26, 2011

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### INFORMATIONAL REPORT

The Governmental Accounting Standards Board (GASB) has been reviewing retirement pension reporting best practices for a number of years. In July 2011, GASB released two exposure drafts proposing changes to rules surrounding financial accounting and reporting of pensions for state and local governments. Amendments to GASB Statement No. 25 would apply to the City's pension plans' financial statements, and amendments to GASB Statement No. 27 would apply to the City's financial statements. GASB will be accepting comments on the proposals through September 30 and holding public hearings in October 2011. Final standards are expected in 2012 to be effective for the City's financial statements for the fiscal year ending June 30, 2013.

The new financial reporting proposals are designed to standardize how pension plans and state and local governments disclose pension information in their financial statements so that it is easier to compare the fiscal health of plans across jurisdictions. The rules only apply to the accounting and reporting of pension information and do not change how the plans' actuaries would calculate the City's Annual Required Contribution (ARC), which is in the Retirement Boards' purview on how local governments would fund their plans.

The proposed rules would result in additional actuarial and accounting work during the preparation of the financial statements. The actual implications for the City or its two plans' financial statements will not be known until the plans' actuaries prepare information under the new standards. It would be helpful to request that the plans' actuaries prepare an analysis under the new standards in order to help the City understand the implications of the proposed rules.

The changes currently proposed by GASB would reduce the City's net financial position (assets minus liabilities) and increase the pension expense recognized by the City in its financial statements. More specifically:

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1. Unfunded pension liabilities (called the net pension liability) would be measured using the market value of plan assets and recorded as a liability on the face of the City's financial statements. At a minimum, not considering other measures proposed by GASB, this would have resulted in a \$2.1 billion unfunded liability (at current discount rates) on the City's balance sheet for the fiscal year ending June 30, 2010 – reducing the City's overall financial position. Under current accounting practices, the unfunded pension liabilities are calculated on an actuarial basis which were \$1.1 billion and included in the notes to the June 30, 2010 financial statements as opposed to actually booking the liability as GASB proposed in the City's financial statements.
2. Governments and pension plans would be required to use a blended discount rate (applied to projected benefits) to determine their pension liability for financial reporting purposes. The blended rate would include (1) the expected long-term rate of return on plan assets on projected benefits for which assets are expected to be available and (2) a lower rate tied to the municipal bond market on benefits for which assets are not expected to be available. Currently, only the long-term rate of return is used. This proposed requirement could result in increasing a plan's calculated pension liability since the lower the assumed rate of return, the higher the net present value of the liabilities. This new proposed accounting rule would require the City to project future plan cash flows to determine whether there is a point in the future at which assets would be insufficient to pay for promised benefits, at which point the discount rate would be adjusted accordingly.
3. Changes to unfunded liabilities would be incorporated into a government's pension expense on an accelerated basis compared to current requirements. Specifically, governments would be required to immediately incorporate into their pension expense any change in liability resulting from the granting of new benefits. Other changes in unfunded liabilities would be recognized immediately for retirees, and amortized over the remaining service lives for active employees. In addition, consistent with the Plans' current policies, governments would be required to recognize (smooth) differences between projected and actual earnings over five years for financial reporting purposes.

The City is potentially in better shape than other governments for two reasons. First, whereas some plans amortize their unfunded liabilities over periods up to 30 years, both of the City's pension plans currently use shorter periods which may more closely align with employees' remaining service periods. For example, the Police and Fire Department Retirement Plan amortizes its pension unfunded liabilities over 16 years and the Federated City Employees' Retirement System amortizes its pension unfunded liabilities over 20 years.

Second, the City's plans already smooth their investment gains and losses over five years to the extent that the Plans' annual returns do not meet the assumed long-term annual rate of return. Although five years is the most common smoothing period among governmental pension plans for investment gains and losses, some plans smooth gains and losses over longer periods.

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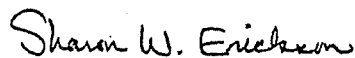
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GASB proposes further accountability and transparency through enhanced disclosures. The proposed rules would increase the amount of information required to be included in the notes to the financial statements. Below are some of the more significant proposed disclosure enhancements:

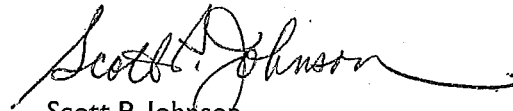
- The basis for selecting the discount rate
- A sensitivity analysis showing the effect on the net pension liability of a 1 percentage point increase or decrease in the discount rate
- The components of the change in the net pension liability
- The components of a government's pension expense
- 10 year schedules containing a variety of pension information

For reference regarding the GASB exposure drafts and GASB's plain-language supplement, please see the following link and the attached GASB news release:

<http://www.gasb.org/cs/ContentServer?site=GASB&c=Page&pagename=GASB%2FPAGE%2FGASBSectionPage&cid=1175804830991>



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APPROVED:



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Attachment

## NEWS RELEASE 07/08/11

### ***GASB Proposes Major Improvements for Pension Reporting***

Norwalk, CT, July 8, 2011—The Governmental Accounting Standards Board (GASB) has issued two Exposure Drafts proposing improvements to financial reporting of pensions by state and local governments: *Accounting and Financial Reporting for Pensions and Financial Reporting for Pension Plans*. The documents would propose amendments to the existing pension standards to improve how the costs and obligations associated with the pensions that governments provide to their employees are calculated and reported.

The first Exposure Draft, *Accounting and Financial Reporting for Pensions* (Pension Exposure Draft), primarily relates to reporting by governments that provide pensions to their employees. A second related Exposure Draft, *Financial Reporting for Pension Plans*, (Pension Plan Exposure Draft), addresses the reporting by the pension plans that administer those benefits.

“Users of state and local government financial reports have told the GASB that current standards do not provide enough information to adequately understand the cost and the liability for benefits promised to active and retired employees,” stated GASB Chairman Robert H. Attmore. “The proposals contained in these Exposure Drafts are the result of years of research and extensive deliberations by the Board to address these issues and make financial reporting of pensions more transparent, comparable and useful to citizens, legislators, and bond analysts.”

Added Mr. Attmore, “It is important to note that these proposals relate to accounting and financial reporting, not to how governments approach the funding of their pension plans. Pension funding is a policy decision made by government officials.”

The Pensions Exposure Draft proposes that governments be required to report in their statement of financial position a *net pension liability* which is the difference between the total pension liability and net assets (primarily investments reported at fair value) set aside in a qualified trust to pay benefits to current employees, retirees, and their beneficiaries. It also proposes significant changes to how a government would calculate its total pension liability and pension expense. These changes include:

- Immediate recognition of more components of pension expense than is currently required, including the effect on the pension liability of changes in benefit terms, rather than deferral and amortization over as many as 30 years which is common for funding purposes.
- Use of a discount rate that applies (a) the expected long-term rate of return on pension plan investments for which plan assets are expected to be available to

make projected benefit payments and (b) the interest rate on a tax-exempt 30-year AA-or-higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust.

- A single actuarial cost allocation method—“entry age normal”—rather than the current choice among six actuarial cost methods. Requiring governments participating in cost-sharing multiple employer pension plans to record a liability equal to their proportionate share of any net pension liability for the cost-sharing plan as a whole.
- Requiring governments in all types of covered pension plans to present more extensive note disclosures and required supplementary information.

The Pension Exposure Draft addresses situations in which another entity contributes to a government’s pension plan on behalf of the employer and it also addresses accounting and financial reporting for employers that provide pensions through defined contribution plans.

The Pension Plan Exposure Draft, which addresses financial reporting for plans that are administered through qualified trusts, outlines the basic framework for the separately issued financial reports of *defined benefit* pension plans. It also details proposed note disclosure requirements for *defined contribution* pension plans.

The Exposure Drafts, including instructions on how to submit written comments, are available for download at [www.gasb.org](http://www.gasb.org). The deadline for submitting written comments is September 30, 2011.

In addition, the GASB has released a comprehensive plain-language supplement to assist non-accountant users of financial statements in commenting on the Pension Exposure Draft. The supplement is also available for download at [www.gasb.org](http://www.gasb.org).

The GASB will host public hearings on the Exposure Drafts on October 3, October 13, and October 20, 2011, and user discussion forums on October 4, 14, and 21. Locations and other details, including instructions for registering to participate, are explained in the Exposure Drafts.

### **About the Governmental Accounting Standards Board**

The GASB is the independent, not-for-profit organization formed in 1984 that establishes and improves financial accounting and reporting standards for state and local governments. Its seven members are drawn from the Board’s diverse constituency, including preparers and auditors of government financial statements, users of those statements, and members of the academic community. More information about the GASB can be found at its website [www.gasb.org](http://www.gasb.org).