



Governmental Accounting Standards Board  
of the Financial Accounting Foundation

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## **New GASB Pension Statements to Bring about Major Improvements in Financial Reporting**

In June 2012, the GASB approved a pair of related Statements that reflect substantial improvements to the accounting and financial reporting of pensions by state and local governments and pension plans. Statement No. 67, *Financial Reporting for Pension Plans*, addresses financial reporting for state and local government pension plans. Statement No. 68, *Accounting and Financial Reporting for Pensions*, establishes new accounting and financial reporting requirements for governments that provide their employees with pensions.

The guidance contained in these Statements will change how governments calculate and report the costs and obligations associated with pensions in important ways. It is designed to improve the decision-usefulness of reported pension information and to increase the transparency, consistency, and comparability of pension information across governments.

Statement 67 replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, for most public employee pension plans. Statement 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, for most government employers. The new Statements also replace the requirements of Statement No. 50, *Pension Disclosures*, for those governments and pension plans.

### **Background**

To ensure that GASB pronouncements continue to be of high quality and are in sync with the continuously evolving government environment, the GASB periodically reexamines its standards. Reexamination typically takes place after a Statement has been in place and fully implemented for at least five years. Research on the GASB's pension standards indicated opportunities for significant improvement.

Governments provide pension benefits through various types of *defined benefit* pension plans, which specify the *amount of benefits* to be provided to the employees after the end of their employment. *Single-employer* pension plans provide pension

benefits to the employees of one employer (a *single employer*). *Multiple-employer* pension plans provide pension benefits to the employees of more than one employer. Under an *agent* multiple-employer pension plan, the assets of a multiple-employer pension plan are pooled for investment purposes but separate “accounts” are maintained for each individual *agent employer*, so that each agent employer’s share of the pooled assets is legally available to pay the pensions of only its employees. In a *cost-sharing* multiple-employer pension plan, *cost-sharing employers* share their assets *and* their obligations to provide pension benefits to their employees—plan assets can be used to pay the pensions of the employees of any employer that provides pensions through the plan. The new Statements address all of these types of plans, as well as *defined contribution* plans, which stipulate the amount to be contributed to employee accounts each year, not the amount of benefits that will be paid in the future.

The Statements apply specifically to governments and pension plans in which a government’s contributions to the trust used to administer a pension plan are (a) irrevocable, (b) restricted to paying pension benefits, and (c) are beyond the reach of creditors. Pension benefits provided through trusts that do not meet those three criteria are not addressed in these new Statements and those pension benefits would continue to be accounted for and reported following Statements 25, 27, and 50.

It is important to note that the new Statements relate to *accounting and financial reporting* issues only—how pension costs and obligations are measured and reported in audited external financial reports. The Statements do not address how governments approach pension plan *funding*—a government’s policy regarding how much money it will contribute to its pension plan each year. While there has been a close relationship between how governments fund pensions and how they account for and report information about them until now, the new guidance establishes a decided shift from the *funding-based* approach to an *accounting-based* approach. The Board crafted its new Statements with the fundamental belief that funding is squarely a policy decision for elected officials to make as part of the government budget approval process.

## **Reporting by Governments in Defined Benefit Plans**

### **Recognizing a Liability Related to Pension Promises for Single and Agent Employers**

State and local government employees often earn two types of compensation in return for their efforts—current compensation and deferred compensation. Salaries and other forms of current compensation reflected in the paycheck are received by employees during their employment. On the other hand, deferred compensation, including pension benefits, is not received until after the employee’s tenure with the government has concluded and vesting and age requirements have been met.

Nevertheless, a government has a present obligation to pay these deferred benefits in the future—a *total pension liability*—once they have been earned. When the total pension liability exceeds the pension plan’s net assets (now referred to as plan net

position) available for paying benefits, there is a *net pension liability*. Governments will now be required to report that amount as a liability in their accrual-based financial statements (for example, the government-wide statement of net position). The pension plan's net position available for paying benefits is to be measured using the same valuation methods that are used by the pension plan for purposes of preparing its financial statements, including measuring investments at fair value.

This is an important change that will more clearly depict the government's financial position. While this information will, in some cases, give the appearance that a government is financially weaker than it was previously, the financial reality of the government's situation will not have changed. Reporting the net pension liability (or asset, if plan net position exceeds the total pension liability) on the face of the financial statements will more clearly portray the government's financial status because the pension liability will be placed on an equal footing with other long-term obligations.

### **Measuring the Pension Liability**

The new pension standards reflect several changes from those currently in place regarding how governments calculate their total pension liability. The measurement process detailed in the new standards involves three essential steps:

1. Projecting future benefit payments for current and former employees and their beneficiaries
2. Discounting those payments to their present value
3. Allocating the present value over past, present, and future periods of employee service.

The standards continue the general existing practice of incorporating expectations of future employment-related events into projections of pension benefit payments—like projected salary increases and projected years of service—if they affect the amount of pension payments employees will receive. Provisions for automatic cost-of-living adjustments (COLAs) and other automatic benefit changes (which generally are written into the pension benefit terms) will also continue to be included in projections. On the other hand, *ad hoc* COLAs and other *ad hoc* benefit changes—which are made at the discretion of the government—will only be included in projections if they occur with such regularity that they are effectively automatic.

To discount projected pension benefit payments to a present value, governments assume a *discount rate*. Standards now in effect require governments to apply a discount rate equal to the long-term expected rate of return on the investments of the pension plan. The long-term expected rate of return will continue to be the starting point for the discount rate. However, the new standard makes it clear that this rate should be applied only to available pension plan assets that are expected to be invested using a strategy to achieve that return.

To the extent that a pension plan's net position and projected contributions associated with active and inactive employees, including retirees, is expected to fully cover projected benefit payments for those individuals, the long-term expected rate of return will be used. If there comes a point in the projections when plan net position and contributions related to active and inactive employees is no longer projected to be greater than or equal to projected benefit payments related to those employees and administrative expenses, then from that point forward a government would be required to discount the projected benefit payments using a municipal borrowing rate—a tax-exempt, high-quality (an average rating of AA/Aa or higher, including equivalent ratings) 20-year general obligation bond index rate.

Finally, benefit payments—discounted to their present value—are allocated to past, current, and future periods. The new standards require all governments to use the entry age actuarial cost method to allocate present value, and to do so as a level percentage of payroll. Under this method, the present value of projected benefits is attributed to employees' expected periods of employment starting from when employees first begin to earn benefits.

### **Calculating Pension Expense**

A government's net pension liability varies from year to year for a variety of reasons, including actual earnings on plan investments, employee compensation changes, interest on the outstanding pension liability, contributions from employers and employees, and actual economic or demographic changes not matching up with assumptions made in the actuarial calculations. When these period-to-period changes should be included in the calculation of the cost of a government's operations—as expenses in the accrual-based financial statements—is a key issue.

The new standards will better align the recognition of pension expense with the period in which the related benefits are earned. Considered in total, the changes set forth by the GASB will have the overall effect of expense recognition being accelerated. Under the new standards, several causes of change in the net pension liability will be factored into the calculation of pension expense *immediately* in the period in which the change occurs:

1. Benefits earned each year
2. Interest on the total pension liability
3. Changes in benefit terms
4. Projected earnings on plan investments
5. Changes in plan net position from other than investments

The effects on the total pension liability of (a) changes in assumptions and (b) differences between assumptions and actual experience are to be recognized initially as deferred outflows of resources or deferred inflows of resources and then introduced into the expense calculation systematically and rationally over the average remaining years of employment of employees (active employees and inactive employees, including

retirees). This period is likely to be significantly shorter than the period of up to 30 years over which governments may now recognize portions of their pension expense.

The difference between the expected earnings on plan investments and actual investment earnings is to be recognized as deferred outflows of resources or deferred inflows of resources and included in expense in a systematic and rational manner over a five-year closed period rather than longer periods that are allowed under the current standards.

### **Reporting by Governments in Cost-Sharing Multiple-Employer Plans**

Under the pension standards now in effect, cost-sharing employers have not been required to present actuarial information about pensions. Instead, information has been required to be presented in the pension plan's own financial statements for all of the participating governments combined.

Through its research, the GASB concluded that the needs of users of information regarding cost-sharing employers do not differ significantly from those interested in single and agent employers. Therefore, the GASB believes it is important to give users of the financial statements of cost-sharing employers access to better, more transparent financial information. Consequently, under the new standards the GASB is requiring that cost-sharing governments report a net pension liability, pension expense, and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the governments in the plan.

### **Note Disclosures and Required Supplementary Information**

The new standards contain requirements for disclosing information in the notes to the financial statements and presenting required supplementary information (RSI) following the notes. Due to the complexity of the array of pension plan features, the Board concluded it was critical that financial statement users have access to certain basic plan information through governments' own financial statements. The Board believes that including this information will enhance the usefulness of financial reports for both decision making and assessing accountability.

All governments participating in a defined benefit pension plan will now include the following information in their note disclosures:

- Descriptions of the plan and benefits provided
- Significant assumptions employed in the measurement of the net pension liability
- Descriptions of benefit changes and changes in assumptions
- Assumptions related to the discount rate and the impact on the total pension liability of a 1 percentage point increase and decrease in the discount rate
- Net pension liability and deferred outflows of resources and deferred inflows of resources.

Single and agent governments also will be required to disclose, for the current period, the beginning and ending balances of the net pension liability, and the effects of changes during the period (such as the effects of service cost, benefit changes, and actual investment earnings).

Single and agent governments will be required to present RSI schedules with the following information for each of the past 10 years (generally on a prospective basis):

- The beginning and ending balances of the total pension liability, the plan trust's net position, and the net pension liability, and their components
- Total pension liability, the plan's net position, the net pension liability, a ratio of the plan's net position to the total pension liability, the covered-employee payroll, and a ratio of the net pension liability as a percentage of the covered-employee payroll.

If a single, agent, or cost-sharing government has an actuarially determined annual pension contribution (or, if not actuarially determined, then the statutorily determined contribution), it is also required to present an RSI schedule with the following information for each of the past 10 years (generally on a prospective basis): (1) the actuarially determined annual pension contribution (or, if not actuarially determined, then the statutorily determined contribution), (2) the amount of employer contribution actually made, (3) the difference between 1 and 2, (4) the payroll of employees covered by the plan, and (5) a ratio of 2 divided by 4.

Governments are also now required to present notes to the RSI schedules regarding factors that significantly affect the trends in the schedules. For single and agent employers, significant assumptions also should be disclosed.

### **Special Funding Situations**

Special funding situations are circumstances in which (a) a *nonemployer contributing entity* (such as a state government) is legally responsible for contributions directly to a pension plan that is used to provide pensions to the employees of another government (such as school districts located within that state) and (b) one or both of the following is true:

1. The nonemployer is the only entity with a legal obligation to make contributions directly to the plan
2. The amount of the contributions for which the nonemployer is legally responsible is not dependent upon one or more events unrelated to the pensions.

In a special funding situation, the nonemployer has essentially assumed a portion of the employer entity's pension obligation as its own. Consequently, if the nonemployer is a government, it will recognize its proportionate share of the net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to the employer's pensions in its own financial statements.

The government benefitting from the nonemployer's contributions in a special funding situation will calculate its net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions prior to the nonemployer government's support, but would *recognize* in its financial statements only its proportionate share.

## **Reporting by Governments in Defined Contribution Plans**

As previously noted, defined *contribution* plans stipulate the *amount to be contributed to an employee's account* each year, and not the amount of benefits employees will receive after the end of their employment. The new standards generally carry forward the existing requirements regarding defined contribution pensions. Governments will report an expense equal to the amount they are required to contribute for employee service each year and a liability equal to the difference between that required contribution and what the government actually contributes. Governments will also make descriptive disclosures about the plan and its terms, and the method by which contributions to the plan are determined.

## **Reporting by Pension Plans**

Statement No. 67 on plan reporting details guidance for financial reporting by *defined benefit pension plans* administered through trusts that meet the criteria described earlier. This guidance generally carries forward the present framework for the separately issued financial reports of defined benefit pension plans. Statement 67 will significantly improve related financial reporting through enhanced note disclosures and new RSI schedules. The Statement also details note disclosure requirements for *defined contribution pension plans* administered through trusts that meet the criteria.

## **Effective Dates**

Statement No. 67 will take effect for pension plans in fiscal years beginning after June 15, 2013 (that is, for years ended June 30, 2014 or later). Statement No.68 will take effect for employers and governmental nonemployer contributing entities in fiscal years beginning after June 15, 2014 (that is, for years ended June 30, 2015 or later). However, the GASB encourages plans and governments to implement the new standards earlier.

## **Obtaining the New Statements**

The new Statements should be available in early August to download free from the GASB website ([www.gasb.org](http://www.gasb.org)) or to purchase in printed form.

- Order a printed copy of [Statement 67](#)
- Order a printed copy of [Statement 68](#)
- Read the [news release](#)