*THE* ***GASB*** *REPORT*

***No. 311 / February 2011***

*(The GASB Report No. 273)*

***GASB Calendar***

The GASB has scheduled the following public meeting dates:

***March 1–3***

***April 12–14***

***May 23–25, Washington, DC***

The GASB also is scheduled to meet via **teleconference** on **March 22** and **May 3.** The precise time, as well as the agenda, will be announced approximately two weeks before each meeting. Unless otherwise indicated, all meetings are held at the Financial Accounting Foundation (FAF) offices in Norwalk, Connecticut.

In addition, the GASB will meet with the Governmental Accounting Standards Advisory Council on March 3 and 4 in Norwalk. Finally, the FAF Trustees will meet on May 25 in Washington, DC.

Please check the GASB website at www.gasb.org three working days prior to meetings to verify the final agenda.

If you plan to attend *any* meetings, please notify Ragan Vincent at (203) 956-5372 or via email at rpvincent@gasb.org. In addition, due to the FAF’s security procedures, visitors to the Norwalk meetings are required to go to www.gasb.org to register at least 24 hours before each meeting they are planning to attend.

***GASB Issues Exposure Draft Addressing Application of Hedge Accounting Termination Provisions***

On February 14, the GASB issued an Exposure Draft, *Derivative Instruments: Application of Hedge Accounting Termination Provisions,* an amendment of GASB Statement No. 53. The Exposure Draft clarifies the application of requirements in Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* that address the termination of hedge accounting.

The proposal is designed to enhance the usefulness and comparability of information on derivative instruments reported by state and local governments by clarifying what constitutes a termination event for accounting and financial reporting purposes.

The need for additional clarity in this respect is necessary because questions have arisen regarding the application of the termination provisions in Statement 53 when a counterparty or a counterparty’s credit support provider of an interest rate swap or commodity swap is replaced because the original counterparty, or counterparty’s credit support provider, failed to comply with the specific terms of a swap agreement.

The scope of the project was originally limited to circumstances involving counterparty bankruptcies. During staff research, however, constituents raised issues involving additional circumstances in which a counterparty, or a counterparty’s credit support provider, is replaced due to other acts of default and termination events, as described in the swap agreement. The proposed clarifying guidance was expanded by the Board to cover those issues.

The proposed Statement is limited to the following circumstances:

• The interest rate swap or commodity swap is a hedging derivative instrument as defined in Statement 53.

• The swap represents a liability of the government.

• The counterparty, or the counterparty’s credit support provider, is replaced with an assignment or an in-substance assignment.

• The government enters into the assignment or in-substance assignment in response to the counterparty, or the counterparty’s credit support provider, either committing or experiencing an act of default or a termination event as both are described in the original swap agreement.

Under the proposal, when a government replaces a counterparty, or a counterparty’s credit support provider, it is required to be done as either an assignment or an in-substance assignment, meaning that only the counterparty, or the counterparty’s credit support provider, has changed and not the key terms of the swap agreement. For a replacement swap to be considered an in-substance assignment, the original swap and the replacement swap agreements are required to be entered into on the same day, and, if there is a difference between the original swap agreement’s exit price and the replacement swap’s price, that difference is attributable to the original swap agreement’s exit price being based upon an average of multiple quotes.

The swap terms enumerated above are included within the proposal because the Board believes they address circumstances in which a government’s counterparty, or a counterparty’s credit support provider, has committed an act of default or triggered a termination event identified in a swap agreement. Without the proposed guidance, a government would be required to cease hedge accounting. This would cause the government to recognize any accumulated deferred amount as an investment loss even if the original swap was an effective hedging derivative instrument and the amended swap or replacement swap has identical terms that continue the effective hedging relationship.

***Proposed Effective Date***

The provisions of the Exposure Draft would be effective for financial statement periods beginning after June 15, 2011. Earlier application is encouraged.

***How to Obtain a Copy of the Exposure Draft***

Copies of the Exposure Draft may be downloaded free of charge from www.gasb.org. Alternatively, a single photocopy of the Exposure Draft may be obtained by calling the GASB Order Department at (800) 748-0659. The comment deadline for the Exposure Draft is April 15, 2011.

***Board Meeting Summary***

The GASB held a public meeting at its office in Norwalk, Connecticut, on January 18–20 to discuss issues associated with its projects on derivative instruments, pension accounting and financial reporting, fiscal sustainability as it relates to economic condition reporting, and deferred inflows of resources and deferred outflows of resources. The Board also met via teleconference on February 8 to discuss issues associated with its project on derivative instruments and pension accounting and financial reporting.

***Derivative Instruments***

At the February teleconference, after making minor clarifying changes to the ballot draft of the Exposure Draft, *Derivative Instruments: Application of Hedge Accounting Termination Provisions,* the Board unanimously approved the proposal for issuance. Please see the related article on page 1.

***Pension Accounting and Financial Reporting***

At the January meeting, the Board discussed issues related to the long-term expected rate of return and actual rate of return disclosures. Specifically, the Board discussed communication of historical actual rates of return by defined benefit plans. The Board tentatively decided to propose that defined benefit pension plans disclose in notes to the financial statements both the current-period time-weighted rate of return, net of expenses, and the current-period money-weighted rate of return, net of expenses. In addition, the Board tentatively agreed to propose that the actual annualized money-weighted rates of return be presented for the current period and for the nine prior periods in required supplementary information. The Board also tentatively agreed that the forthcoming Exposure Draft should encourage, but not require, reporting all required years of information retroactively. The Board tentatively decided not to propose that multi-year rates of return (for example, a five-year average) be disclosed in notes or presented in required supplementary information in the plan financial statements.

The next area of discussion focused on the potential development of detailed requirements related to the selection of the long-term expected rate of return. The Board tentatively decided to propose that in addition to requiring that current actuarial standards of practice be applied in developing the long-term expected rate of return on plan investments, defined benefit pension plans also be required to disclose:

• The best estimate for the long-term expected real rate of return for each major asset class

• Information about whether the expected rates of return are presented as arithmetic or geometric means

• Information about how the combined long-term expected term rate of return was developed.

Continuing redeliberation of issues addressed in the June 2010 Preliminary Views, *Pension Accounting and Financial Reporting by Employers,* the Board considered the comments and testimony received regarding expense recognition of changes in a sole or agent employer’s net pension liability resulting from changes in plan net assets. The Board tentatively reaffirmed its position stated in the Preliminary Views that projected earnings on plan investments, calculated using the long-term expected rate of return, should be included in the determination of pension expense in the period in which the earnings are projected to occur.

The Board also reconsidered the approach to the effects on expense recognition related to the differences between projected and actual earnings on plan investments proposed in the Preliminary Views and tentatively decided to propose that differences between projected and actual earnings on plan investments be reported as deferred inflows and outflows of resources and be allocated and recognized in pension expense over a closed five-year period instead of using a corridor approach as outlined in the Preliminary Views. In addition, the Board considered the comments and testimony received on its Preliminary Views regarding expense recognition of changes in a sole or agent employer’s net pension liability resulting from changes in the total pension liability. The Board tentatively decided to revise its initial position and to propose that the effect of a change of plan terms on the total pension liability be recognized as expense in the period of the change, regardless of the active or inactive classification of the employee.

The Board also reaffirmed its preliminary view that changes in the total pension liability resulting from differences between expected and actual experience with regard to economic or demographic factors or assumption changes regarding the expected future behavior of economic and demographic factors should be deferred and recognized as expense over a period representative of employees’ expected remaining service lives. To the extent that such changes relate to past service of inactive, including retired, employees, the Board reaffirmed its view that such changes should be recognized as pension expense immediately in the period of change. To the extent that such changes relate to past periods of service of active employees, the Board reaffirmed its preliminary view that expense should be recognized using a systematic and rational approach over a closed period.

In addition, the Board tentatively agreed to propose that the period be an average expected remaining service life of the employees with which the change is associated, with weighting to approximate the result that would be obtained if such changes were recognized over each active employee’s service life. In addition, the Board reaffirmed its preliminary view that the service-cost component of pension expense should be the amount attributed to the current period by the entry age actuarial cost method and that interest on the beginning total pension liability should be recognized as pension expense each period.

At the February teleconference, the Board continued discussion of potential actuarial assumption requirements, including detailed mortality-related assumptions and experience studies. The Board tentatively decided that detailed information about mortality adjustments and mortality improvement assumptions should not be required to be disclosed. With regard to experience studies, the Board tentatively agreed that the Exposure Draft should not include a minimum frequency requirement; however, the Board did agree that the date of the last experience study should be disclosed.

The Board also discussed potential limits on the application of the entry age normal attribution method and considered both the traditional entry age normal method and the ultimate/replacement entry age normal method. The Board tentatively decided that the attribution method defined in the Exposure Draft should exclude the use of approaches such as ultimate/replacement entry age normal in which measurements of service costs are not individually based. The Board will continue deliberations on additional variations to the entry age normal attribution method at a later meeting.

Finally, the Board discussed whether a requirement should be established related to the allocation of an employer’s net pension liability among funds in the fund financial statements and between governmental and business-type activities in the government-wide statement of net assets. The Board tentatively decided that allocation provisions in the standards associated with the reporting model were adequate and, therefore, the employer Exposure Draft should not include allocation guidance of this type.

***Economic Condition Reporting: Fiscal Sustainability***

At the January meeting, the Board reached a tentative agreement on specific measures that collectively are necessary for users to make an assessment of a governmental entity’s fiscal sustainability. These specific measures include:

• Projections of the major individual inflows of resources in dollars and as a percentage of total inflows of resources along with explanations of the known causes of resource fluctuations (including nonrecurring resources)

• Projections of the major individual outflows of resources by program or function in dollars and as a percentage of total outflows of resources along with explanations of the known causes of resource fluctuations

• Projections of major individual financial obligations and total financial obligations including bonds, pensions, OPEB, and long-term contracts

• Projections of annual debt service payments (principal and interest)

• Narrative discussion of the major intergovernmental service interdependencies that exist and the nature of those service interdependencies.

The Board also discussed task force feedback regarding how to define and measure the concept of “mandates.” The Board reached a tentative agreement that *the percentage of major outflows of resources that are mandated versus discretionary* is not an essential measure of the effects of fiscal interdependencies between governmental entities because of the difficulty, from a practical standpoint, in defining and measuring mandates. The Board tentatively agreed that a narrative discussion of how mandates may cause fluctuations in future major individual outflows of resources would be more appropriate and is already encompassed within the specific measure *projections of the major individual outflows of resources by program or function in dollars and as a percentage of total outflows of resources along with explanations of the known causes of resource fluctuations.*

Finally, the Board discussed how to define major in relation to inflows of resources, outflows of resources, financial obligations, and intergovernmental service interdependencies. The Board directed the staff to conduct additional research to determine what governmental entities would report as major under differing scenarios.

***Deferred Inflows of Resources and Deferred Outflows of Resources***

Beginning deliberations on the deferred inflows and deferred outflows of resources omnibus project at the January meeting, the Board tentatively agreed that the most pressing project issues are determining which balances should be reclassified as deferred inflows and deferred outflows of resources and the approach under which these determinations should be made. The Board also tentatively agreed on a list of items currently classified as assets or liabilities that could potentially qualify as a deferred inflow or deferred outflow of resources. Finally, the Board reconfirmed the overall approach it will apply in determining whether or not to reclassify certain items. In determining which items to reclassify, the Board will first assess whether the item meets the definitions of an asset or liability. If the item does not meet the definition of an asset or liability, the Board will determine if the item meets the definitions of a deferred inflow of resources or a deferred outflow of resources.

AT THE PODIUM

***GASB at the Podium***

The following is a selected list of upcoming national and regional events in which GASB members and staff are scheduled to participate. Additional information about upcoming speaking engagements and other Board and staff activities can be found at the GASB website (www.gasb.org) by clicking on the “Calendar” link.

If you are interested in having a GASB representative speak at your event, please contact Mary Milligan at (203) 956-5290 or via email at mmilligan@gasb.org.

***Vermont Government Finance Officers’ Association—Training Program***

***Date:*** March 16

***Location:*** Saxtons River, VT

***GASB Speaker:*** Lisa Parker

***American Accounting Association—Government and Nonprofit Section—Mid-Year Meeting***

***Date:*** March 18 and 19

***Location:*** Birmingham, AL

***GASB Speaker:*** Dean Mead

***Native American Finance Officers’ Association—Spring Finance Conference***

***Date:*** March 23

***Location:*** Pala, CA

***GASB Speaker:*** Roberta Reese

***National Association of State Comptrollers—Annual Meeting***

***Date:*** March 23

***Location:*** Phoenix, AZ

***GASB Speakers:*** Robert Attmore, David Bean

***National Association of State Treasurers—Annual Legislative Conference***

***Date:*** March 29

***Location:*** Washington, DC

***GASB Speaker:*** Robert Attmore

***New York State Government Finance Officers’ Association—Annual Conference***

***Date:*** April 6

***Location:*** Albany, NY

***GASB Speaker:*** Dean Mead

***Washington Society of Certified Public Accountants—Governmental Accounting & Auditing Conference***

***Date:*** April 18

***Location:*** Tacoma, WA

***GASB Speaker:*** David Bean

***Idaho Centennial Chapter of the Association of Government Accountants—Spring Professional Development Conference***

***Date:*** April 20

***Location:*** Boise, ID

***GASB Speaker:*** David Bean

***National Association of College and University Business Officers—Higher Education Accounting Forum***

***Date:*** April 20

***Location:*** Boston, MA

***GASB Speaker:*** Wesley Galloway

***American Public Power Association—General Accounting, Finance, & Audit Spring Meeting***

***Date:*** April 22

***Location:*** Washington, DC

***GASB Speaker:*** Wes Galloway

***Illinois Society of Certified Public Accountants—Government Conference***

***Date:*** April 25 and 26

***Location:*** Oak Brook, IL and Springfield, IL

***GASB Speaker:*** Scott Reeser

***North Carolina State Treasurers—Accounting Management Conference***

***Date:*** April 28 and 29

***Location:*** Hickory, NC and New Bern, NC

***GASB Speaker:*** David Bean

***Maryland Society of Certified Public Accountants—Government and Not-for-Profit Conference***

***Date:*** April 29

***Location:*** College Park, MD

***GASB Speaker:*** Ken Schermann

***New York State Society of Certified Public Accountants—Government Accounting and Auditing Conference***

***Date:*** May 3

***Location:*** Albany, NY

***GASB Speaker:*** Robert Attmore

***Colorado Fiscal Managers’ Association—Spring Conference***

***Date:*** May 5

***Location:*** Loveland, CO

***GASB Speaker:*** David Bean

***Missouri Society of Certified Public Accountants—Governmental Accounting Conference***

***Date:*** May 5

***Location:*** Columbia, MO

***GASB Speaker:*** Wes Galloway

***New Hampshire Government Finance Officers’ Association—Annual Conference***

***Date:*** May 5

***Location:*** North Conway, NH

***GASB Speaker:*** Lisa Parker

***Utah Association of Certified Public Accountants—State and Local Government Conference***

***Date:*** May 6

***Location:*** Salt Lake City, UT

***GASB Speaker:*** David Bean

***Oklahoma Society of Certified Public Accountants—Governmental Accounting & Auditing Conference***

***Date:*** May 6

***Location:*** Oklahoma City, OK

***GASB Speaker:*** Lisa Parker

***Connecticut Society of Certified Public Accountants—Governmental Accounting and Auditing Conference***

***Date:*** May 10

***Location:*** Southington, CT

***GASB Speaker:*** Jeff Bridgens

***Southern Wisconsin Chapter of the Association of Government Accountants—Annual Spring Symposium***

***Date:*** May 10

***Location:*** Madison, WI

***GASB Speaker:*** Lisa Parker

***Florida Institute of Certified Public Accountants—FSU, Spring Accounting Conference***

***Date:*** May 12

***Location:*** Tallahassee, FL

***GASB Speaker:*** Todd Webster

***Louisiana Government Finance Officers’ Association—Spring Conference***

***Date:*** May 13

***Location:*** Lafayette, LA

***GASB Speaker:*** David Bean

***Oregon Society of Certified Public Accountants—Annual Governmental Accounting & Auditing Conference***

***Date:*** May 16

***Location:*** Eugene, OR

***GASB Speaker:*** David Bean

***South Carolina Association of Certified Public Accountants Government and Benefit Plans Conference***

***Date:*** May 19

***Location:*** Columbia, SC

***GASB Speaker:*** David Bean

***Arkansas Division of Legislative Audit Continuing Professional Education Institute***

***Date:*** May 26

***Location:*** Little Rock, AR

***GASB Speaker:*** Lisa Parker

***The GASB Report***

The GASB welcomes feedback on *The GASB Report.*

Managing Editor: Christine L. Klimek

Email: clklimek@f-a-f.org

Editor: Kip Betz

Email: jcbetz@gasb.org

Write: 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116

Telephone: (203) 847-0700

GASB website address: www.gasb.org

***Subscription questions and address changes:***

Barbara Diliberto

Email: bldiliberto@f-a-f.org

Fax: (203) 847-6045

***To order GASB publications:***

(800) 748-0659 or [www.gasb.org](http://www.gasb.org)