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

***No. 327-A / June 2012***

*(The GASB Report No. 289)*

***GASB Calendar***

The GASB has scheduled the following public meeting dates:

***July 10–12***

***August 22–24***

The GASB also is scheduled to meet via **teleconference** on **September 10.** 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.

The FAF Board of Trustees will meet on August 21 in New York City.

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 *all* meetings are required to go to www.gasb.org to register at least 24 hours before each meeting they are planning to attend.

***GASB Improves Pension Standards***

In June 2012, the GASB approved two pronouncements that will significantly improve the accounting and financial reporting of pension information 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. The new standards will lead to significant improvements in the consistency, comparability, and transparency of pension information reported by employers, which will greatly enhance its usefulness for making decisions and assessing accountability.

The genesis of the new Statements was the GASB’s comprehensive review of the effectiveness of its pension standards, which is a part of the GASB’s broader effort to periodically examine the effectiveness of its existing standards.

The new standards establish a distinct shift from the current *funding-based* approach to an *accrual accounting-based* approach. Based on this approach, governments will now be required to report their net pension liability in their statement of financial position. This important change will more accurately represent the government’s financial position and place the pension liability on an equal footing with other long-term obligations.

***Measuring the Total Pension Liability***

The new pension standards change how governments will measure the total pension liability. The measurement involves three traditional steps employed by actuaries:

1. Projecting future benefit payments

2. Discounting those payments to their actuarial present value

3. Allocating the present value over past, present, and future periods of employee service.

The standards carry forward the general current practice of incorporating expectations of future employment-related events into projections of pension benefit payments (for example, projected salary changes and projected years of service). Provisions for automatic cost-of-living adjustments (COLAs) and other automatic benefits changes, which generally are written into the pension benefit terms, will continue to be included in projections. Ad hoc COLAs, which are made at the discretion of the government, will be included only 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. To the extent that a pension plan’s net position associated with active and inactive employees is expected to fully cover projected benefit payments for those individuals, this rate 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, then from that point forward a government would be required to discount 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 yield or index rate.

As previously noted, 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, projected benefits are discounted to their present value when employees first begin to earn benefits and are attributed to employees’ expected periods of employment.

***Calculating Pension Expense***

A government’s net pension liability (asset) changes from year to year for a number of reasons. When these period-to-period changes should be recognized as a cost of a government’s operations—as expenses in the accrual-based financial statements—is a key issue. To better align recognition of pension expense with the period in which the related benefits are actually earned, the new standards require several causes of change in the net pension liability (asset) to be factored into the calculation of pension expense immediately in the period the change occurs, including:

• Benefits earned each year

• Interest on the total pension liability

• Changes in benefit terms

• Projected earnings on plan investments

• Changes in plan net position from other than investments.

However, 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 (both active and inactive, including retirees). This period is likely to be significantly shorter than the period of up to 30 years over which governments may now spread their pension expense.

The effects of differences between the expected earnings on plan investments and actual experience are 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 current standards.

***Cost-Sharing Multiple-Employer Plans***

Governments participating in cost-sharing multiple-employer plans currently are not required to present actuarial information about the plan. Rather, information is required to be presented in the pension plan’s own financial statements for all of the participating governments combined.

Because the GASB determined that the needs of the users of financial statement information about cost-sharing plans and their participating governments are no different from the needs of those interested in governments participating in single-employer and agent multiple-employer pension plans, the new standards require that cost-sharing governments report a net pension liability (asset), pension expense, and pension-related deferred inflows and outflows of resources in the statement of financial position based on their proportionate share of the collective amounts for all the governments in the plan.

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

The GASB’s new standards contain requirements for disclosing information in the notes to the financial statements and presenting required supplementary information (RSI) following the notes. 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 liability of a 1 percent change 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 total pension liability, assets held for pension benefits, and the net pension liability, and their components (such as the effects of service cost, benefit changes, and projected investment earnings).

Single and agent governments will now 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

• (1) Total pension liability, (2) the plan trust’s net position, (3) the net pension liability, (4) a ratio of 2 divided by 1, (5) covered-employee payroll, and (6) a ratio of 3 divided by 5.

If a single, agent, or cost-sharing government has an actuarially determined annual pension contribution (or, if not actuarially determined, then statutorily or contractually determined), it also is 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 statutorily or contractually determined), (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 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 refer to circumstances under which (1) a *nonemployer contributing entity* is legally responsible for contributions directly to a pension plan that is used to provide pensions to the employees of a government and (2) one or both of the following is true:

a. The nonemployer is the only entity with a legal obligation to make contributions directly to the plan.

b. 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 such a 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 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 it will *recognize* in the financial statements amounts *net* of the nonemployer contributing entity’s proportionate share.

***Defined Benefit vs. Defined Contribution Plans***

Defined benefit plans specify the amount of benefits to be provided to the employees after the end of their employment. Participating governments make contributions to the plan in order to accumulate assets, which will be available in the future to make the promised benefit payments. *Defined contribution* plans, however, stipulate only the *amounts 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.

***Defined Contribution Plans***

The new standards generally carry forward the existing requirements regarding defined contribution plans. Participating 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 and actual contribution. Governments also will make descriptive disclosures about the plan and its terms, and the method by which contributions to the plan are determined.

***Reporting by Pension Plans***

The Statement on plan reporting details guidance for financial reporting by *defined benefit pension plans* administered through trusts that meet the criteria described above. 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 67 will take effect for pension plans in fiscal years beginning after June 15, 2013. Statement 68 will take effect for employers and governmental nonemployer contributing entities in fiscal years beginning after June 15, 2014. However, the GASB encourages plans and governments to implement the new standards earlier.

***How to Obtain Copies***

Statements 67 and 68 (product codes GS67 and GS68, respectively) may be pre-ordered through the GASB Order Department by calling (800) 748-0659 or through the Store section of the GASB website at www.gasb.org. The documents also will be available for free download in early August on the GASB website under the Pronouncements tab. Keep an eye on the GASB website for additional information about the availability of both hard copies and electronic versions of the new Statements.

***GASB Issues Exposure Draft on Financial Guarantee Transactions***

In June, the GASB approved for issuance an Exposure Draft of a proposed Statement, *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions.* The comment deadline is September 28.

The Exposure Draft proposes guidance regarding the recognition and disclosure of financial guarantees made and received by state and local governments. Governments typically provide several types of financial guarantees, which are primarily associated with commitments to ensure payments on debt issued by other entities.

For the purposes of this proposal, a financial guarantee refers to a transaction that involves three legally-separate parties:

1. The guarantor or entity providing the guarantee of a separate entity’s legal obligation

2. The issuer—the entity that issues the obligation that is being guaranteed, and

3. The bondholder—the entities that purchase the obligation.

When a government is the provider of a financial guarantee, the guarantee represents potential claims on its resources. When a government receives a guarantee, the guarantee represents potential resources.

When a government guarantees the financial obligation of another government and the guarantor government does not receive equal value in return, the transaction is referred to as a *nonexchange transaction.* Guarantor governments typically enter into the kind of financial guarantees at issue here with a goal to assist other entities within their jurisdiction to reduce borrowing costs. Guarantees of this nature provide an additional assurance to bondholders and serves to minimize their credit risk.

Many types of state and local governmental entities issue and receive financial guarantees, including general purpose governments, special-purpose governments, and governmental entities that engage in business-type activities.

***Existing Guidance***

While some relevant accounting and financial reporting guidance for financial guarantees does exist within GASB literature, it derives from a variety of sources. Governments primarily apply the accrued loss contingency guidance contained in Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which was carried forward from the Financial Accounting Standards Board’s Statement No. 5, *Accounting for Contingencies,* FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* and FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others.*

This guidance was originally designed to address exchange transactions occurring in the private sector. Consequently, it addresses circumstances not typically encountered in the government environment. The guidance now proposed by the GASB, however, is expressly designed to address governmental entities. Specifically, the proposed guidance addresses nonexchange transactions in which the governmental guarantor is not receiving resources of equal value in return, which is typically the case for financial guarantees in the government environment.

Due to the increasing prevalence of these kinds of guarantees and the potential for them to result in claims due to the current economic climate, there is a need for clear and consistent recognition and disclosure guidance that derives from a single source and is designed specifically for nonexchange transactions that occur in the government environment.

***What Would the Proposal Require?***

The proposed Statement would require a government that extends a financial guarantee to recognize a liability if and when qualitative factors indicate that it is more likely than not that the government will actually make a payment as a result of the guarantee agreement. Qualitative factors could include such events as the issuer experiencing a significant financial hardship, like the loss of a major revenue source; breaching a debt contract, such as a failure to meet rate covenants; or initiating the process of entering into bankruptcy protection proceedings or a financial reorganization. In circumstances in which a government extends groups of similar guarantees, the proposed Statement would require a government to assess qualitative factors and historical data on frequency of default in relation to the group of guarantees rather than each individual guarantee.

The amount of the liability to be reported would be the best estimate of the costs expected to be incurred. When there is no best estimate but a range of estimated costs can be established, the amount of the liability would be the minimum amount within the range.

The proposed Statement would provide that a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation should continue to report a liability until legally released as an obligor. In situations in which a government is released as an obligor, the government would recognize revenue as a result of being relieved of the obligation.

***Note Disclosures***

In addition, the proposed Statement would clarify the information required to be disclosed by governments that extend and receive financial guarantees as a result of nonexchange transactions. The disclosures proposed are designed to provide users of governmental financial information with information about the nature and amount of the financial guarantees entered into by governments, including the parties to the agreement, and the period covered by the guarantee.

***Proposed Effective Date***

The requirements of the proposed Statement would be effective for periods ending after June 15, 2013. Early application would be encouraged.

***How to Obtain Copies of the Exposure Draft***

Copies of the Exposure Draft may be downloaded free of charge from www.gasb.org. The comment deadline is September 28. Additional details on how to provide comments to the GASB on the proposal are available in the front of the Exposure Draft.

***Board Meeting Summary***

The GASB held a public meeting on May 30–June 1 in Norwalk, Connecticut, to discuss issues associated with a number of projects, including those on pension accounting and financial reporting, financial guarantees, the measurement and application of fair value, and financial projections as they relate to economic condition reporting.

The Board also met on June 18 in Seattle, Washington, in conjunction with the American Public Power Association’s National Conference to discuss issues related to its projects on pension accounting and financial reporting, and financial guarantees.

In addition, the GASB also met via teleconference on June 25 to discuss issues related to its project on pension accounting and financial reporting and to discuss the update to the *Comprehensive Implementation Guide.*

***Pension Accounting and Financial Reporting***

In its pension accounting and financial reporting project, the Board considered issues related to transition provisions, the money-weighted rate of return, and field test participant feedback on the impact of significant tentative changes to the proposals in the Exposure Drafts, *Accounting and Financial Reporting for Pensions,* and *Financial Reporting for Pension Plans.*

With respect to its consideration of transition provisions, the Board discussed situations in which some employers might report measures of pension-related information determined in conformity with Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* while the related plan will be required to present information measured under the proposed new Statement. The Board considered whether the final Statement for employers should include an accommodation to allow employers that continue to report using the current pension requirements to use measurements from an actuarial valuation not more than 36 months from the beginning of their fiscal year for biennial calculations. The Board tentatively agreed that this accommodation should not be included and that the final Statement should continue to require employers to use measurements from an actuarial valuation no greater than 24 months from the beginning of their fiscal year.

The Board next considered whether the final Plan Statement should include additional guidance about the calculation of the money-weighted rates of return that tentatively would be required to be presented in notes and required supplementary information (RSI) in a defined benefit pension plan’s financial report. The Board tentatively agreed that the discussion of the money-weighted rate of return should be modified to specify that it should be calculated as the internal rate of return on plan investments. In addition, the Board tentatively agreed that the cash flows needed to calculate the money-weighted rate of return should be measured on an accrual basis at least monthly, with shorter measurements (for example, daily) encouraged. The Board also tentatively agreed that the final standard should indicate that the measurement of investment expense includes investment management and custodial fees and all other significant investment-related costs.

The Board considered comments received from field test participants who provided feedback on a summary of significant tentative changes that the Board has made to the proposals in the Exposure Drafts to help assess whether the Board’s tentative changes would address specific cost concerns that the respondents expressed during the field test. Based on this analysis and other forms of information provided during the Board’s due process, including comment letters, public hearing testimony, and user forum feedback, the Board again considered the expected benefits of the proposals for accounting and financial reporting for pensions and accounting and financial reporting for pension plans, as tentatively modified for its deliberations of comments received in response to the Exposure Drafts. The Board also considered the anticipated costs to preparers and users of employer and plan financial statements of applying the revised requirements. After considering these issues, the Board decided to move forward with the review of the preballot drafts.

In discussing the preballot drafts of the final Employer and Plan Statements, the Board directed the staff to make certain clarifying changes that will be incorporated into the ballot drafts. During this review, the Board tentatively agreed to eliminate proposed requirements for single and agent employers to disclose details of the components of pension expense and details of changes in pension-related deferred outflows of resources and deferred inflows of resources balances. In addition, the Board tentatively agreed that, if an employer’s contributions are not actuarially determined but statutorily or contractually determined, the employer should present a 10-year schedule in RSI that compares, for each fiscal year, the statutorily determined employer contribution and the amount of employer contributions made in relation to the statutorily determined employer contribution, and present related ratios.

At the June 25 teleconference, the Board approved for issuance Statements No. 67, *Financial Reporting for Pension Plans,* and No. 68, *Accounting and Financial Reporting for Pensions.* (See article on page 1.)

***Financial Guarantees***

In its project on financial guarantees, the Board discussed the current guidance for accounting and financial reporting for guarantees of special assessment debt. The Board tentatively decided that the financial guarantees project should not include guarantees for special assessment debt accounted for under Statement No. 6, *Accounting and Financial Reporting for Special Assessments,* as these guarantees are part of exchange transactions.

The Board also discussed whether a guarantor should be allowed to discount a financial guarantee liability and tentatively decided that the liability recognized by a government for a financial guarantee that is a nonexchange transaction should be measured at its present value.

Continuing its discussion by considering issues related to the measurement of revenue recognized by a government that has issued a guaranteed obligation for payments made by the guarantor, the Board tentatively decided that revenue recognized by a government that has issued a guaranteed obligation for the guarantee payments made by the guarantor should be limited to the reduction in the liabilities previously recognized by the guarantor. Interest expense/expenditures reported by the issuer of the guaranteed obligation should be reported net of interest-related payments made by the guarantor if it is not required to be repaid.

The Board continued its discussion by reviewing a preballot draft of the proposed Statement. During this review, the Board tentatively decided to eliminate specialized guidance from the draft proposal related to a government extending a financial guarantee, as a result of a nonexchange transaction associated with an obligation of another entity within the government’s own reporting entity. The Board also provided suggestions to the project staff for clarifying revisions to the document.

At the June 18 public meeting, the Board approved for issuance an Exposure Draft of a proposed Statement, *Accounting and Financial Reporting for Nonexchange Financial Guarantee Transactions.* (See article on page 1.)

***Fair Value Measurement and Application***

In its project on fair value measurement and application, the Board continued with its two-part approach by reviewing and discussing a compilation of the Board’s tentative decisions to date. That compilation is to be used for reference for the application portion of this project.

In addition, the Board tentatively agreed to propose that fair value revisions resulting from a change in a valuation technique or its application be accounted for as a change in accounting estimate.

***Economic Condition Reporting—Financial Projections***

In its project on financial projections as they relate to economic condition reporting, the Board received a summary of the comments received on the Preliminary Views, *Economic Condition Reporting: Financial Projections,* which the project staff categorized as “Generally Agreeing” and “Generally Disagreeing.”

The Board also received a summary of the field test feedback and the user discussion feedback from the National Federation of Municipal Analysts annual conference in May and the Governmental Research Association annual conference in April. The presentation was an informational update and no decisions were made.

***Who’s Who at the GASB***

*In June, the GASB marked the departure of two postgraduate technical assistants who completed their terms and assumed new positions.*

***Maria Cancro*** will join Ernst & Young as a senior associate within the firm’s financial accounting advisory services department in New York, New York. She came to the GASB from Pennsylvania State University, State College, Pennsylvania, where she received a master’s degree and a bachelor’s degree in accounting. During her tenure at the GASB, Ms. Cancro was a member of the conceptual framework, accounting and financial reporting for other postemployment benefits, and leases teams.

***Jaclyn Geary*** will join Ernst & Young as a senior associate within the firm’s financial accounting advisory services department in Chicago, Illinois. She came to the GASB from Indiana University, Bloomington, Indiana, where she received a master’s degree in accounting and a bachelor’s degree in business administration, which focused on accounting and technology. During her tenure at the GASB, Ms. Geary worked on Statements No. 65*, Items Previously Reported as Assets and Liabilities,* No. 67*, Financial Reporting for Pension Plans,* and No. 68, *Accounting and Financial Reporting for Pensions.* She also worked on the Exposure Draft, *Government Combinations and Disposals of Government Operations,* and was a member of the GAAP hierarchy project team.

***The GASB Report***

The GASB welcomes feedback on *The GASB Report.*

Managing Editor: Christine L. Klimek

Email: [clklimek@f-a-f.org](mailto: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)