



**Governmental Accounting Standards Board  
of the Financial Accounting Foundation**

**May 2009**

## **GASB Considering Whether Pension Standards Can be Improved**

The Governmental Accounting Standards Board (GASB) has issued an Invitation to Comment on Pension Accounting and Financial Reporting. The Invitation to Comment marks the beginning of the process that is designed to provide the Board with an opportunity to consider whether modifications to the pension standards are required to better meet the financial reporting objectives of accountability and decision usefulness, including enabling users of financial reports to assess the extent to which interperiod equity has been achieved.

The Invitation to Comment raises several key pension accounting and financial reporting issues that were identified during research regarding the application and effectiveness of the current standards. The document is designed to elicit comments at this early stage of the process of reexamining its current pension accounting and financial reporting standards set forth in GASB Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 27, Accounting for Pensions by State and Local Governmental Employers, as amended.

### **What Does the ITC Say?**

An Invitation to Comment is a preliminary staff document that seeks input before the GASB members have reached a consensus opinion. Rather than set forth a draft of proposed standards, the ITC describes the issues and offers alternative approaches to addressing them. The first chapter of the Invitation to Comment introduces the document's background and objectives. Chapters 2–7 each address a key area of accounting and financial reporting for pensions and then pose questions that are intended to elicit public response. The chapters present more than one view on each issue, along with some of the relevant arguments that are or could be made for and against each view, to stimulate thinking in regard to the issues and the questions on which response is sought.

### **The Focus of Accounting and Financial Reporting**

Chapter 2 considers the fundamental issue of what defined benefit pension processes, transactions, or other events should be the focus of financial reporting. At

the conclusion of this chapter, respondents are asked to consider whether pension financial reporting should focus on (1) the process by which an employer incurs an obligation to employees, (2) the process by which an employer finances its projected future cash outflows, or (3) both processes.

Some believe that financial reporting should focus on the process by which an employer incurs an obligation to its employees to provide pension benefits in retirement. Financial reporting would focus on measuring and recognizing the effects on the employer's obligation to plan members for earned benefits of the employment exchange, the employee services received to date, the specific terms pertaining to pension benefits, and related transactions and other events.

Some believe that financial reporting should focus on the annual pension contributions an employer would need to make on a regular basis in order to pay the normal cost and amortize the unfunded accrued benefit obligation within a number of years considered acceptable for financial reporting. Still others believe that information from both views should be provided.

### **Recognizing Liabilities and Expenses**

Chapter 3 addresses the recognition of employers' pension liabilities and expenses. The chapter first describes concepts related to liabilities and flows of resources and criteria for recognition in basic financial statements. It then presents three alternative approaches to the recognition of transactions and other events related to pensions in basic financial statements of sole and agent employers. Each approach is a reflection of a combination of ways of resolving issues raised in the chapter regarding (1) determination of what pension liability should be reported and (2) how pension costs should be attributed to periods.

With regard to pension liabilities, respondents are asked to consider whether the obligation that meets the conceptual definition of a liability of the employer is (a) a measure of the difference between the annual contributions necessary to maintain acceptable progress toward full funding and the contributions actually made, (b) a measure of the employer's unfunded accrued benefit obligation associated with services received from employees to date, or (c) something else.

In addition, respondents are asked to consider whether employers should (i) recognize the effects of various pension-related transactions or other events immediately upon occurrence or (ii) amortize the effects of some or all transactions or other events (other than normal cost) over future periods for expense recognition in resource flows statements prepared with a flow of economic resources measurement focus on the accrual basis of accounting.

## **Measuring Pension Obligations**

Chapter 4 examines alternative approaches to the measurement of pension obligations for accounting and financial reporting purposes. Types of future changes affecting benefits that are discussed in this chapter include automatic and ad hoc cost-of-living adjustments (COLAs), projected future salary increases of plan members, and projected future service credits. Issues discussed include (1) whether ad hoc COLAs should be included in the projection of benefits if there is a pattern of serial ad hoc COLAs that could be considered part of the substantive plan terms and (2) at what point salary increases and service credits should be incorporated into the projection of benefits for financial reporting purposes. The connection of views on the latter issue to the focus of financial reporting on the incurrence of benefit obligations or the funding of benefits (the issue addressed in Chapter 2) is discussed.

Additionally, Chapter 4 presents views on what rate should be applied to discount projected benefits to their present value for accounting purposes. Alternatives presented include the estimated long-term investment yield for the plan, a risk-free rate of return (or yield curve of risk-free rates of return); the employer's borrowing rate; and the interest rate on high-quality municipal bonds. Arguments for and against each of these approaches are presented.

## **Actuarial Methods**

Chapter 5 considers the use of actuarial methods in accounting measurement approaches that involve the amortization of some components of pension cost over future periods for expense recognition—a subject that would be relevant if the Board were to adopt such an approach after due process. It includes discussion of issues related to actuarial cost methods, such as the number of actuarial cost methods that should be permitted (that is, should six current methods that are allowed in the GASB parameters be retained, limited, or expanded) and the manner in which various methods allocate the present value of projected pension benefits among past, present, and future periods.

The chapter also discusses the allocation (amortization) of the unfunded accrued benefit obligation over future reporting periods. Key issues pertaining to amortization include (1) whether and within what limits recognition of some components of pension cost as expense in future periods should be permitted; (2) whether different maximum amortization periods should apply to different components of pension cost (for example, benefit changes and actuarial gains and losses); (3) whether a single amortization basis, either closed or open, should be required; and (4) whether the maximum amortization period or periods should vary depending on the amortization basis and methods chosen, if options are permitted.

Chapter 5 also presents views on how the actuarial value of plan assets should be determined for financial reporting purposes. The chapter discusses whether the determination of the actuarial value of plan assets should include methods that allocate

the effects of fair-value changes over more than one year—and, if so, what constraints, if any, should be placed on the use of such techniques. It also considers whether there should be a disclosure of the funded status of the benefits that reflects the fair value of plan assets at the measurement date.

## **Cost-Sharing Plans**

Chapter 6 examines issues specific to employers' participation in cost-sharing multiple-employer pension plans. In cost-sharing multiple employer plans, the benefit obligations and contributed assets of the participating governments are pooled together, rather than attributed to the governments individually. Respondents are asked to consider whether the relationship between a cost-sharing employer and the plan in which it participates differs enough from the relationship of a sole or agent employer to its plan to warrant different liability and expense recognition requirements.

This chapter presents three views regarding the requirements for cost-sharing employers. Supporters of one view believe current measurement, recognition, and disclosure requirements appropriately account for the pension cost and obligation of an employer in a cost-sharing plan. Others believe that the current measurement and recognition requirements are appropriate; however, they also believe that additional disclosures by cost-sharing employers are needed. Finally, proponents of a third view believe a cost-sharing employer has a long-term pension obligation based on the employment exchange and should measure and recognize its obligation and expense in a manner similar to that for sole and agent employers. The question for respondents at the end of this chapter is framed in terms of these views.

## **Reporting by Pension Plans**

Chapter 7 asks respondents to consider two questions relating to accounting and financial reporting by defined benefit pension plans. The first question relates to what a pension plan should report as the plan's liability in regard to pension benefits. The chapter discusses one view that supports the plan recognizing a liability for benefits currently due and payable and another view in favor of the plan recognizing a liability for the accrued benefit obligation (as determined based on feedback to the proposals in Chapters 2-5).

The second question posed in Chapter 7 relates to whether a presentation of changes in the unfunded accrued benefit obligation should be a required part of general purpose external financial reporting. If respondents believe that the presentation should be made, they are further asked if it should be in the financial reports of the employer, the plan, or both. The chapter also inquires as to whether the presentation should be a basic financial statement, in the notes to the basic financial statements, or in required supplementary information.

## **What Does the GASB Need to Know?**

The ITC poses questions intended to elicit feedback that will help the GASB to determine the direction the reexamination of its pension standards will take. The GASB needs its constituents to answer these questions so that it can identify the best approaches and potentially develop proposed changes to the accounting and financial reporting standards.

You can answer the questions using an Internet-based form or via mail or email. You are encouraged to read the ITC and the accompanying plain-language supplement (PLS) and all of the questions prior to answering. The ITC and PLS can be downloaded free-of-charge from the GASB's Web site ([www.gasb.org](http://www.gasb.org)). The written comment deadline for the Invitation to Comment is July 31, 2009. The GASB also would welcome any other comments or suggestions that constituents may have.