GASB & Moody's

Changes in accounting standards and pension debt reporting presented by VRS

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Rory J. Badura, ASA, EA, MAAA
Senior Policy, Planning & Compliance Analyst

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GASB Changes

The Government Accounting Standards Board (GASB) recently approved two new standards which will substantially change the accounting and financial reporting of public employee pensions by state and local governments:

- Statement No. 67, *Financial Reporting for Pension Plans,* revises existing standards for pension plans. Effective for periods beginning after June 15, 2013.
- Statement No. 68, *Accounting and Reporting for Pensions*, requires employers to report unfunded pension liabilities on their balance sheet for the first time. Effective for fiscal years beginning after June 15, 2014.

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GASB Key Requirements

- Reporting of “Net Pension Liability”
- Modified pension expense
- No asset smoothing
  - Assets will be reported at fair value or marked to market
- Blended discount rate
  - 20-year general obligation municipal bond index rate for expected unfunded liabilities
- Apportionment of liability (Multiple Employer Plans)
  - Contributing employers must report a liability on their own financial statements
- Entry-age normal cost method required
- Additional disclosures

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Comparison of Key Funding & Accounting Assumptions for VRS

	Discount Rate	Amortization Period	Asset Value	Annual Cost
VRS Board (Funding)	7.0%	30 years decreasing to 20 years Level percent of pay	5-year smoothing of gains/losses	Normal Cost plus 30-year level-percent of pay amortization of unfunded liability (Amortization will decrease to 20 years)
GASB 68 (Accounting)	VRS Board rate for funded liabilities & municipal bond index for unfunded liabilities. (Blended Rate)	Changes in liabilities for retired members and any changes due to plan amendments must be expensed immediately. Changes in liabilities for active members (other than for plan amendments) can be amortized over their future working lifetimes. Differences between actual and assumed investment returns must be recognized as pension expenses over a five-year period.	Fair Market Value	Normal Cost plus interest on pension liability plus effect of changes in benefit terms plus amortization of deferred inflows/outflows over either expected working lifetime of actives or 5 years depending on source

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Impact of Changes

- Significant liability stated on financial statements
  - Focus of statements shifts from entity's commitment to fund its obligation to a funded status snapshot in time
- Marked to market will increase volatility of accounting expense
- Immediate recognition of changes in liability due to plan amendments and accelerated recognition of changes in liability due to actuarial gains and losses and changes in actuarial assumptions
- De-linking Pension Expense (the ARC) and Pension Funding
  - Confusion with differences with new pension expense and pension funding requirements
  - Old GASB expense (the ARC) served as a standard for responsible funding
  - Many employers relied on GASB standard for funding, new basis will need to be developed
- May require two actuarial valuations or significant effort to develop update procedures
  - Increased cost/effort
- Result in increased audit effort

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Impact of GASB Changes Example

Participating Employer of State Plan with 1.8% share of Teachers Multiple Employer Plan

State Plan

	Funding / Current Accounting	GASB 68
Discount Rate	7.0%	7.0%*
Liability	$500 Million	$500 Million
Normal Cost	$12 Million	$12 Million
Assets	$350 Million	$340 Million
Funded Status	70%	68%
Funding Contribution	20.23% of pay	N/A
Accounting Expense	20.23% of pay	27.5% of pay
Balance Sheet - NPL	$0	$160 Million

Teachers Multiple-Employer Plan

	Funding / Current Accounting	GASB 68
Liability	$35 Billion	$35 Billion
Assets	$25 Billion	$24.5 Billion
Funding Contribution	21.77% of pay	N/A
Accounting Expense	21.77% of pay	29.59% of pay
Balance Sheet - NPL	$0	$230 Million

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* Assumes assets cover future liabilities and no blended rate needed.

Moody's Proposed Changes

On July 2, Moody's Investor Services issued a request for comment on its proposal to implement adjustments to the pension liability and cost information reported by state and local governments and their pension

Moody's Proposed Adjustments

- Discount Rate
  - Actuarial accrued liability (AAL) would be discounted using a high-grade long-term corporate bond index rate - currently 5.5%
- No Asset Smoothing
  - Asset valuation smoothing would be eliminated in favor of reported fair value of assets as of the actuarial reporting date
- Uniform Amortization Period
  - 17-year level dollar amortization payment
- Apportionment of Liabilities (Multiple Employer Plans)
  - Liabilities would be allocated proportionately according to each employer's share of the total contribution

Comparison of Key Funding/ Accounting/Debt Rating Assumptions

	Discount Rate	Amortization Period	Asset Value	Annual Cost
VRS Board (Funding)	7.0%	30 years decreasing to 20 Level percent of pay	5 -year smoothing of gains/losses	Normal Cost plus 30-year level-percent of pay amortization of unfunded liability (Amortization will decrease to 20 years)
GASB (Accounting)	VRS Board rate for funded liabilities & municipal bond index for unfunded liabilities. (Blended Rate)	Changes in liabilities for retired members and any changes due to plan amendments must be expensed immediately. Changes in liabilities for active members (other than for plan amendments) can be amortized over their future working lifetimes. Differences between actual and assumed investment returns must be recognized as pension expenses over a five-year period.	Fair Market Value	Normal Cost plus interest on pension liability plus effect of changes in benefit terms plus amortization of deferred inflows/outflows over either expected working lifetime of actives or 5 years depending on source
Moody's (Debt)	High-grade long-term corporate bond index rate. (Currently 5.5%.)	17-year level dollar	Fair Market Value	Normal cost (at new discount rate) plus 17-year level-dollar amortization of Unfunded Liability

Impact of Changes

- Funded ratios will be impacted
- Marked to market will increase volatility
- Impact of Ratings on local governments
  - Having unfunded liabilities valued at municipal bond rate may force localities to fund pensions to maintain funded ratios
- May require additional valuation or require significant effort to justify differences with valuation
  - Increased cost /effort
- Result in increased audit effort

Impact of Moody's Proposed Changes Example

Participating Employer of State Plan with 1.8% share of Teachers Multiple Employer Plan

State Plan

	Current Funding	Moody's
Discount Rate	7.0%	5.5%
Liabilities	$500 Million	$600 Million
Normal Cost	$12 Million	$15.3 Million
Assets	$350 Million	$340 Million
Unfunded Liability	$150 Million	$260 Million
Funded Status	70%	56.7%
Amortization Period	30 Years	17 Years
Annual Contribution Requirement	20.23% Payroll	37.5% Payroll

Teachers Multiple-Employer Plan

	Current Funding	Moody's
Liabilities	$35 Billion	$42 Billion
Assets	$25 Billion	$24.5 Billion
Unfunded Liability reported by Locality	$0	$316 Million

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Thank you!