TRANSPARENCY OF GASB 67 & 68, THE DEMISE OF DEFINED BENEFIT PENSION PLANS

Hall, Steven D.
Texas A&M University-Corpus Christi

ABSTRACT
Governmental Accounting Standards Board (GASB) has instituted some of the most strict measurement and disclosure requirements for the entities under their authority. This comes at a time when governmental entities have suffered a great recession and have had accounting rules that were not transparent.

INTRODUCTION
There are many different types of pensions most of them can be broken down into defined benefit plans, and defined contribution plans. Pension plans are supposed to be a guaranteed commitment and for that reason, defaults in payments are deemed unacceptable. In today reality, most of the governmental retirement plans are not solvent, and there hopes for solvency is a lost cause.

In the United States the exact number of public pension plans is not known; however, there are over 90,000 state and local governments that offer pension plans. Most of the plans are defined-benefit pension plans. When retirement begins, this type of plan guarantees the employee a monthly benefit. Pensions differ; however, typically, the monthly income is determined by finding a percentage of the employee's final or highest salary and is adjusted to reflect the number of years of employment (Ellman 374). Defined benefit pension plans have been abandoned by for profit entities. FASB made it difficult to over these plans without showing the liability for underfunded. Until recently GASB (Governmental Accounting Standards Board) had not required valuation techniques that showed the true liability the government entities are responsible for. The current state of the pension system is a fiscal time bomb due to the underfunding of pensions and the inability of municipalities to pay out those benefits (Beermann 4).

A pension is funded when assets are accumulated during an employees working life, typically through a combination of employer and employee contributions. Computing the liability for a defined benefit pension plan is done on an actuarial basis, which means that budgeting for the cost of the pension plan is found through an actuarial valuation. The actuarial valuation is determined by a pension plan's condition, required contributions and liabilities. The actuary is required to arrive at estimates to reach an estimate of the projected benefit obligation. The funding of a public pension plan is expressed by its actuarial funding level, which is calculated by dividing the actuarial value of the plan's assets by its liabilities (Brainard 30). Government pensions are funded from governmental revenue, which is dependent upon taxes (Heck 93). Governments create a financial liability for taxpayers when future payments to workers are promised. These payments start when a worker retires. Preparation must be done to fulfill these

obligations. Governments contribute, and in some instances manage their own pension funds, which creates large pools of money that are invested in stock, bonds and other financial instruments. The money that is paid to an employee who retires must be equal to the money that was accumulated over their period of employment. A pension plan is considered an "unfunded liability" when accrued liabilities exceed the actuarial value of the plan's assets (Ellman 375). Significant modifications to these pension plans are protected by constitutional and contract law theories (Beermann 37).

The current flaws with the design of the pension are numerous. The first flaw is that pensions are funded from governmental revenues, which are linked to property values. When those values decline, cities face financial hardship similar to the current economic crisis (Heck 93). With decreasing revenues, governments implement budget cuts or increase taxes to make up the lack of revenues. The recent turn in the economy has resulted or caused declining property tax, employment tax, and sales tax. This has brought a bought a decline in public employment and shrinking of pension trust fund reserves. Funding pensions with these diminishing revenue sources is not economically feasible (Heck 96).

The issue of pensions not being fully funded is another flaw to the sustainability of the entity. Public pensions are considered adequately funded at the 80% level because public employers are assured to be more financially stable than private sector corporations (Ellman 368-369). When compared to private employers, municipalities have had more freedom to make their own choices about funding methods and policies (Ellman 368). In 2009 the average public pension was 65% funded and was continuing to fall (Ellman 369). In July 2012, public pensions in the United States where only around 41% funded (Beerman 12). The underfunding occurs because most government pensions are defined benefit plans, and by law do not require full advance funding of the projected cost of accrued benefits except over the period worked by the employee. During good economic times, governments have increased employee compensation including pension promises. In contrast to bad fiscal times, these same governments have foregone or reduced pension contributions to fund other services (Beermann 30). These underfunded pension plans are either deliberately underfunded or are due to assumptions concerning investment performance and the amount that will be owed over time (Beermann 6). There is a need to increase contributions to these pension plans because future pension payments will be made from current revenues. If this is to occur, local governments could be insolvent (Beermann 6).

Presently the city of Detroit has successfully entered bankruptcy citing the pension plan as a creditor which it is seeking relief from. This is unlike the bankruptcies in California which the pension plans having not been listed for relief.

> A federal judge has given a green light for Detroit to proceed with its bankruptcy, the largest municipal bankruptcy in history.
> The ruling opens the door for the city to cut billions of dollars in payments that are owed to city employees, retirees, investors and other creditors.

> Unions and pension funds had argued that the city should not be eligible to use bankruptcy court protections. They said that regardless of the Detroit's financial troubles, city and state officials did not negotiate with creditors in good faith in an effort to reach a deal on its liabilities.
> In his ruling, the judge found the city did not meet that threshold, yet he ruled that such negotiations were impractical because of the huge number of creditors, which total more than 100,000. So, ultimately, he concluded that the city filed its petition properly. (Hicken2013)

The ruling of the court has opened the gates for other cities, counties, and government entities to seek pension relief from the courts. Emergency Manager Kevyn Orr, (Detroit) has proposed slashing more than $9 billion of $11.5 billion in unsecured debt in order to fix the city's finances. This could mean draconian cuts to the pension benefits and retiree health care coverage. Investors holding debt issued by Detroit would receive only pennies on the dollar.

The current retirement system is fought with flaws, but there are reforms that are taking place to avoid the financial ruin of the entity First, states and municipalities are raising the age and tenure requirements for new hires and cutting cost of living increases for new and even retired individuals. Rather than offering a tradition pension some plans are adding 401k style saving retirement plans. Others have converted their plans to cash-balance plans. These plans have an account for the employee in which the employer manages. This allows for a guaranteed minimum return (Smith13-14). Even with the threat of municipalities filing bankruptcy, many state laws prohibit modifying a worker’s pension benefit (Heck 112). Even though laws protect worker’s pension benefits, pension cuts have occurred but are rare (Smith 13). In order to save the retirement benefits that are owed to current and retired employees, serious discussion is required by the employer, politicians, and other entities that are involved with this potential crisis.

The previous account rules did not allow for the transparency that is needed to evaluate the health of the entity, have incorporated the help of more financially inclined bodies like GASB (Governmental Accounting Standards board of the Financial Accounting Foundation) and FASB (Financial Accounting Standards Board) to help set up guidelines for the sake of transparency and to help them meet their contractual obligations. Institutions like GASB are charged with establishing standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions provided to the employees of state and local governmental employers through pension plans. Unfortunately, Government plans across the nation have been faced with challenging financial issues and some forced to file for bankruptcy, meaning the probability of meeting their contractual obligations are currently being threatened by gaps in the financial guidelines set by the very institutions set in place to prevent such a debacle, and secondly, because of sheer neglect, carelessness or lack of transparency on the part of governments.

According to an article in the New York Times, cities, like Vallejo, California, declared bankruptcy earlier this year after locking itself into paying police officers and firefighters benefits

so costly that they swamped the city's finances. As mentioned in the article, no one would knowingly create a pension plan like that, but under the now old accounting rules of governments, officials can get in over their heads rather easily without knowing it because the old methods of accounting can understate the cost of benefits, making them look affordable even when they are not. The hidden cost can then compound overtime and become crushing. For example, the old rules which caused a lot of these issues, allow for governments to give retirees retroactive pension increases without recognizing the added cost resulting in assets being overstated. Secondly, certain governments like the state of New Jersey and the city of San Diego implemented versions of skim funds – which are accounting devices that allow officials to declare certain investment income to be ''excess', Skim it out of the pension fund and spend it on other things. Skim funds are not allowed in the private sector but are acceptable in the government sector. Such allowances in the rules or guidelines set by accounting rule making bodies like GASB enable governments to use unusual accounting methods that make their pensions look fully funded at all times even when there are big investment losses. For example, according to an online article by Gary Findaly, government pension plans were allowed to use the aggregate actuarial funding method which allowed the accrued liabilities to be equal to the plans assets resulting in a plan always appearing to be 100% funded regardless of the size of the assets held.

Government pensions typically cannot be rescinded because they are protected by law and state constitutions, even if they prove unaffordable. According to the New Times article, although GASB can write tighter accounting rules, it has no authority to crack down on governments that go astray unlike the Financial Accounting Standards Board which is backed up by the S.E.C. As a result of this, government pensions are not forced to adhere to the rules and guidelines provided by GASB even though they are strictly advised to. For this reason, government pension plans sometimes adopt practices contrary to what was proposed by GASB. For example, as per the New York time article, the rules call for pension deficits to be closed over 30 years, in a process called amortization but most places have begun using a 50 year and even 100 year amortization schedule. Others use the required 30 year schedule but restart the 30 year period at year 1 every year. Also, government pension plans due to neglect, carelessness and lack of accountability, are guilty of practices that make their numbers look better than they are really should be by implementing some of the skims mentioned above such as Skim funds, giving them more funds to use on other projects or initiatives. Other examples or negligence include government pension plans allocating cost, expenses or liabilities from the current period to future periods, thus overstating their assets. As earlier mentioned, these cost then compound overtime and become crushing and hence government pension plans are forced to file for bankruptcy because they truly do not have enough assets to meet their obligations.

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. In this light, GASB has since taken steps to rectify or close these gaps by amending their guidelines to better protect pensioners, provide transparency by ensuring better financial reporting

is being done. According to the GASB website, examples of such changes that have been enacted in an effort to close gaps in from the past guidelines include but are not limited to;

1. The net pension liability initiative which requires a government to report a net pension liability on its financial statement when total pension liability exceeds the pensions plan's net assets. Before, accrued liabilities were equal to assets, leading to overstated assets. This will more clearly depict the government's financial position.

2. 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 rather than pushing it to future periods. The new standards will better align the recognition of pension expense with the period in which the related benefits are earned. Expense would be deferred and recognized over a period equal to the average remaining service periods of active and inactive (including retirees) employees for differences between expected ad actual changes in economic and demographic factors and changes in assumptions about economic and demographic factors.

3. Government pension plans are required to project future benefit payments for current and former employees and their beneficiaries and discount those payments to their present value allocating the present value over past, present and future periods of employee service assuming a discount rate equal to the long-term expected rate of return on the investments of the pension plan rather than the current market value or rate.

In conclusion, the importance of government pension plans to the workforce (past, present and future), to the economy (present and future) and to its citizens requires a lot of transparency on the part of both the guidelines being established by accounting rule making bodies such as GASB as well as government officials in charge of these pension plans. Because GASB pronouncements are required auditing firms, government pensions are going to have a huge responsibility to conform to the guidelines in order to avoid fiascos such as filing for bankruptcy.

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