Presented to Senate Finance Committee

September 2012
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Objective

Contrast the upcoming changes in accounting standards with the proposed requirements of Moody's Investors Service

New Pension Standards

- GASB recently issued 2 new pension standards
  - GASB 67 covers accounting and reporting by pension plans (VRS) – effective 6/30/2014
  - GASB 68 covers accounting and reporting by employers (Commonwealth) – effective 6/30/2015
- These standards do **not** address how governments approach pension funding

GASB Key Requirements

- Reporting of net pension liability
- Modified pension expense
- No asset smoothing
- Blended discount rate
- Apportionment of liability
- Entry-age normal cost method required

Key Change: Net Pension Liability

- Conceptual shift in reporting pension liabilities and expenses - from a “funding” approach to an “earnings” approach
- Currently the government does not report a liability if it fully funds the annual required contribution

Key Change: Net Pension Liability continued

- New approach requires:
  - Reporting a pension liability as employees earn their benefits by providing services
  - Net pension liability reported in the accrual-based statements equals the total pension liability less the assets that have been accumulated to fund those benefits
- This will treat the pension liability in a similar manner as other long-term obligations

Calculation of Liability

- Three step process:
  - Projecting future benefit payments for current and former employees and their beneficiaries
  - Discounting those payments to their present value
  - Allocating the present value over past, present, and future periods of employee service (actuarial methodology)

Key Change: Calculation of Expense

- Part of the change in total pension liability from year to year is immediately included in expenses in the accrual-based financial statements
- Part is deferred to later years, using various timeframes

Key Change: Calculation of Expense cont.

- In the past, the GASB expense (Annual Required Contribution or ARC) was also standard for responsible funding
- New funding model is being developed by the Academy of Actuaries and the Government Finance Officers Association

Key Change: No Asset Smoothing

- Investments will be marked to market immediately
- This will increase the volatility of the accounting expense
- In past VRS has smoothed over 5 years

Key Change: Discount Rates

- Discount rate used to discount the payments
  - Current standards require a discount rate equal to the long-term expected rate of return on the Plan's investments; this continues in part
  - If there are not sufficient investments to cover all of the projected benefit payments, then for that portion not covered, new standards require us to use a municipal borrowing rate (tax-exempt, high-quality 20-year GO Municipal Bond index rate)

Key Change: Allocation of Liability

- Employers participating in a cost-sharing multiple-employer plan must recognize their proportionate share of the collective amounts for the plan as a whole
- For Virginia, this means the liabilities for the teachers in VRS will be allocated to the localities

Key Change: Actuarial Method to Use

- New standards require all governments to use the entry-age normal cost method to allocate present value, at a level percentage of payroll
- VRS already uses this method

Moody's Proposal

- Consistency across all plans when making comparisons
- Treat pension liabilities more like other debt obligations
- Do it sooner than GASB will take effect

Moody’s: 4 Principal Adjustments

- Multiple-employer cost-sharing plan liabilities will be allocated to specific employers based on proportion of current contributions (sooner than GASB and GASB will use expected long-term contributions)
- Common discount rate used by all based on high quality corporate bonds – it will be 5.5% starting out (GASB allows plan to use average of expected rate of return and 20 year bond rate)

Moody's: 4 Principal Adjustments, continued

- Eliminate asset valuation smoothing and instead use reported fair value of assets as of the valuation date (Consistent with GASB, just earlier)
- Recalculate annual pension contribution based on the new common discount rate (5.5%) and common amortization period (17 years)

Potential Future Moody’s Changes

- COLAs
- Mortality tables
- Wage growth assumptions
- Cost methods

Effect on Bond Rating

- Moody's has said that the proposed adjustments will not result in any state rating actions as they have been monitoring pensions at the state level
- The proposal may impact local governments whose adjusted liabilities after the allocation are outsized for their rating category.

Concerns

- Moody's believes they can make the adjustments on their own; however, in a trial run VRS was only able to trace one figure after Moody's adjustments
- Concern that competing multiple calculations will cause confusion

Comparison of Current, GASB, & Moody's

	VRS	GASB	Moody's
Discount Rate	7%	Blended	5.5%
Amortization Period	30 years decreasing to 20	Some expensed immediately, some over future working lifetimes, investment returns over 5 yrs	17 years
Asset Value	5 year smoothing	FMV	FMV
Annual Cost	Normal Cost + amortization of unfunded over 30 years (decreasing to 20)	Normal Cost + interest on pension liability + amortization with varying periods	Normal Cost at new discount rate plus 17 year amortization of unfunded liability