

GASB Update

16th Biennial Forum
of Government Auditors

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Discussion Topics

- Recent Final Pronouncements
- Exposure Drafts and Preliminary Views
- What Will Be Issued Soon?
- Other Current Projects
- Research Agenda

The views expressed in this presentation are those of Mr. Attmore. Official positions of the GASB are determined only after extensive due process and deliberation.

Recently Issued Final Pronouncements

Recent Final Pronouncements

- Statement 45 – Accounting and Financial Reporting by Employers for OPEB (6/04)
- Statement 46 – Net Assets Restricted By Enabling Legislation (12/04)
- Statement 47 – Accounting for Termination Benefits (6/05)

Recent Final Pronouncements (continued)

- Implementation Guides
 - OPEB—Statements 43 and 45
 - Statistical section—Statement 44
 - Comprehensive—2005 edition
- New User Guide – Notes and S.I.

Effective Dates For 6/30 YE

- June 30, 2006
 - Statement 34, Retroactive infrastructure—Phase I
 - Statement 42
 - Statement 44
 - Statement 46
 - Statement 47
- June 30, 2007
 - Statement 34, Retroactive infrastructure—Phase II
 - Statement 43—Phase I
- June 30, 2008
 - Statement 43—Phase II
 - Statement 45—Phase I

Statements 43 and 45

Other Postemployment Benefits

What Do You Need to Know?

OPEB Statements Effective Dates

- Phased implementation based on same “phase” used for Statement 34
- Benefit Plan implementation is for years beginning after December 15, 2005, 2006, or 2007
- Employer implementation is for years beginning after December 15, 2006, 2007, or 2008
- Earlier application is encouraged

Why Are We Discussing This Now?

- All about planning
- Significant policy implications that are not 11th hour considerations
 - Should changes (if any) be made to the plan?
 - Fund or not to fund?
 - When should an actuary (if any) be engaged?

What is the Substance of the OPEB Transaction?

- Postemployment benefits (both pensions and OPEB) are part of the compensation for services rendered by employees—that is, they are part of an exchange transaction

What are the Reporting Objectives?

- Recognize OPEB cost (expense) systematically over periods approximating employees' years of service
- Provide relevant information about:
 - (a) actuarial accrued liabilities for promised benefits associated with past service,
 - (b) the annual cost of OPEB, and
 - (c) progress made in funding the plan

What is an Employer OPEB Plan?

- The plan as understood by the employer and plan members
- Should be based on the types of benefits provided at the time of each valuation, including any changes made and announced to plan members

Measurement— A Statement 27 Approach

- All postemployment benefits (OPEB as well as pensions) will be reported using the same general approach.
- Broad steps:
 - Project cash outflows for benefits
 - Discount projected benefits to present value (PV)
 - Allocate the PV of projected benefits to periods using an acceptable actuarial cost method

Employee Age Timeline

Service Period



Assumed age at retirement

Age when hired

Life Expectancy

Present age

Recognition in Government-wide and Proprietary Fund Financial Statements

- Employers would report OPEB expense in an amount equal to annual OPEB cost for the period, regardless of the amount paid
- The cumulative difference between amounts expensed and contributions or benefits paid would create a liability (or asset) called the net OPEB obligation

Why Are Implicit Rate Subsidies So Important?

- When current employees and retirees are in the same group—costs for retirees generally are significantly higher
- Therefore, retirees that pay for the cost of healthcare benefits through a blended (with current employees) premium often are not paying the actual costs of their benefits

Implicit Rate Subsidies

- Difference between the “common” premium charged and the actual rate needed if retirees’ rate was calculated as separate group
- Even if employer does not otherwise contribute to retirees’ benefits

Implicit Rate Subsidy Example

Employees	Number	Monthly Cost	Age-adjusted Premium	Blended Premium
Active	400	\$80,000	\$200	
Retired	100	\$40,000	\$400	
Total	500	\$120,000		\$240

How Frequently Should An Actuarial Valuation be Done?

- OPEB plans with total membership (active employees and retired) over 200—at least biennially
- OPEB plans with total membership of 200 or fewer—at least triennially
- OPEB plans with total membership of 100 or fewer—option to use alternative calculation method with certain simplifying assumptions

What Disclosures Are Required for Employers?

- Plan description
- Funding policy
- Information on employer contributions for the current year
- Information on the Net OPEB Obligation (if any)
- Limited trend information
- Information on the funding status for the current year
- Information of actuarial methods and assumptions used

Statement 46

Net Assets Restricted by
Enabling Legislation

GASB 46 Background

- Statement 34 identifies three sources of restrictions on net assets—external parties, constitutional provisions, and enabling legislation
- Enabling legislation is a type of legislation that authorizes the raising of a new revenue (*not* earmarking existing revenues) and that contains a legally enforceable restriction on the purpose for the use of those revenues

Objectives of GASB 46

- Amendment of GASB 34 to address practice issues raised
- Provides clarification regarding legal enforceability
- Requires note disclosure of amount restricted by enabling legislation
- Effective for years beginning after 6/15/05

Legal Enforceability

- Legal enforceability means that an external party—such as citizens, a public interest group, or the judiciary—can compel a government to abide by the restriction
- Remains a matter of professional judgment, which may include reviewing determinations for similar legislation, obtaining the advice of legal counsel, or other actions

Legal Enforceability

- Restrictions should be reviewed on a case-by-case basis:
 - If a restriction is found to no longer be legally enforceable, a government may reevaluate the legal enforceability of similar restrictions, but should not necessarily conclude that all such restrictions are unenforceable
 - Prohibitions against one legislature binding a subsequent legislature generally are not, on their own, sufficient basis for determining a restriction is not enforceable

Statement 46—Effective Date

- Periods beginning after June 15, 2005
(June 30, 2006 and December 31, 2006)

Statement 47

Accounting For Termination Benefits

Accounting for Termination Benefits

- Inducements or payments for early termination of services
 - Voluntary and involuntary
- Recognition issues in accrual basis financial statements
 - Voluntary – when the offer is accepted and amount can be estimated
 - Involuntary – when the offer is communicated to employees and amount can be estimated

Accounting for Termination Benefits (continued)

■ Measurement Issues

- Healthcare-related benefits
- Non-healthcare related benefits
- Effect on employer's defined benefit postemployment benefit obligations

■ Disclosure requirements

■ Effective Dates

- Periods beginning after June 15, 2005
- Exception for defined benefit OPEB

New GASB User Guide

- *What Else You Should Know about a Government's Finances: A Guide to Notes to the Financial Statements and Supporting Information*
- Plain-language guide covers all notes, RSI and SI, including the new statistical section, OPEB, and derivatives
- More than 80 annotated illustrations
- Companion volume to prior User Guides to financial statements

Exposure Drafts and PV

- Sales and Pledges of Receivables and Future Revenues – ED (9/05)
- Pollution Remediation Obligations – ED (1/06)
- Medicare Part D Payments – TB (2/06)
- Accounting and Financial Reporting for Derivatives – PV (4/06)

Sales and Pledges of Receivables and Future Revenues

Exposure Draft

Primary Guidance

- Transactions of this nature should be reported as a collateralized borrowing unless the conditions required for reporting as a sale are met.

Sales—Receivables

- Principle—No continuing involvement in transaction
- Criteria
 - Transferee's ability to sell or pledge the receivables is not restricted
 - Receivables are isolated from the transferor government
 - Transferor does not have the ability to unilaterally remove specific accounts

Sales—Future Revenues

- Principle—no continuing involvement in the transaction
 - Own-source revenues and most other future revenues will not qualify
- Revenue recognition—period in which the revenue relates, will result in deferral of proceeds

Project Timetable

- Exposure Draft—September 2005
- Final Statement—September 2006

Accounting and Financial Reporting for Pollution Remediation Obligations

Exposure Draft

Types of Remediation Obligations

- Pre-cleanup activities: site assessment, feasibility study, design
- Cleanup activities: neutralization, containment, disposal activities
- Oversight and enforcement costs
- Operation and maintenance of the remedy and monitoring

Recognition Threshold

- Determine whether one or more components of a pollution remediation obligation are recognizable as a liability when . . .
 - Government knows or reasonably believes that a site is polluted, and
 - Obligating event occurs

Obligating Events

- Imminent endangerment compels action
- Violate pollution prevention permit
- Named as responsible party
- Named in lawsuit to enforce action
- Voluntary remediation commenced

Recognition

- Recognize components of liability as they become reasonably estimable
 - Recognition benchmarks
- Cost accumulation, not fair value
- Current value, not present value
- Expected cash flow technique would be required

Capitalization Criteria

- Outlays to prepare property for anticipated sale
- Outlays to prepare property for use when known polluted property was acquired and expected to be remediated
- Outlays to restore pollution caused decline in service utility that was recognized as an asset impairment
- Outlays to acquire assets that will have alternative uses other than remediation efforts

Project Timetable

- Preliminary Views—March 2005
- Public Hearing—June 2005
- Exposure Draft—January 2006
- Statement—November 2006

Accounting and Financial Reporting for Derivatives

Preliminary Views

What is a Derivative for Financial Reporting Purposes?

- Settlement factors: One or more reference rates and one or more notional amounts
- Leverage: Requires no (or little) initial net investment
- Net settlement: Can be readily settled net

Examples of Derivatives

■ Interest rate swap

- Variable-rate to fixed-rate
- Fixed-rate to variable-rate

■ Basis swap

- Exchange payments based on the changes of two variable rates

■ Swaption

- Gives the purchaser of the option the right, but not the obligation, to enter into an interest rate swap

Examples of Derivatives (continued)

- Commodity swap
 - Reduce exposure to a commodity's price risk

Tentative Measurement Decision

- Report derivatives at fair value with hedge accounting in some circumstances
 - Changes in fair value of derivative are deferred for qualifying transactions
 - Changes in fair value of derivative would not be deferred if the related asset (for example, investment) is reported at fair value
- How is that operationalized?

What is a Hedge?

- Management's objective is to establish a hedge—reduce a specified risk
- Hedging instrument is a derivative
- Derivative is associated with a hedgeable item

Hedge Effectiveness Tests

- Consistent critical terms
- Synthetic instrument
- Quantitative techniques

What Happens With Hedge Ineffectiveness?

- Disclosed for derivatives that qualify for hedge accounting

Derivative Disclosures

- Application of TB-2003 disclosures to all derivatives, including objective(s) of derivative; significant terms; risks; and associated debt.
- Summary of derivative activities by type
 - Beginning fair values
 - Fair value of derivatives acquired during the period (at time of acquisition)
 - Fair value of derivatives that matured or terminated
 - Changes in fair value during the period
 - Ending fair values
 - Ending notional amount

Project Timetable

- Preliminary Views document issued April 28, 2006
- Public hearings on Preliminary Views document—June 2006 and July 2006
- User roundtable—July 2006
- Comments to PV due July 28, 2006
- Exposure Draft first quarter of 2007
- Final standard fourth quarter of 2007

What Will Be Issued Soon?

- **Accounting for Medicare Part D Payments – Final TB in June ?**
- **Elements of Financial Statements C.S. – ED in August**
- **Sales and Pledges of Receivables and Future Revenues – Final in September**
- **Fund Balance Reporting – ITC in October**

Other Current Projects

- **Intangible Assets – ED in November**
- **Comprehensive Implementation Guide Update - September**
- **Recognition and Measurement Attributes - Concepts Statement**

Research Agenda

- Economic Condition Reporting
- Electronic Financial Reporting
- Intergovernmental Financial Risks
- Pension Accounting and Reporting
- Reporting Units / Statement 14 Revisited
- Service Efforts and Accomplishments Reporting

Questions?



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