CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

May 7, 2012

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Tracy McCraner, Finance Director
(949) 644-3123 or tmccraner@newportbeachca.gov

SUBJECT: GASB PENSION REPORTING AND DISCLOSURE UPDATE

ABSTRACT:

The Finance Director attended the California Debt and Investment Advisory Commission (CDIAC) seminar on Municipal Market Disclosure: Applications to Pension Obligations on Thursday, May 3, 2012. One discussion was an update from David Sundstrom (GASB Board Member) and Alan Milligan (CalPERS Chief Actuary) regarding the proposed amendment to GASB Statement No. 25 on Pension reporting and disclosure requirements; this update will be provided to the Finance Committee.

BACKGROUND

The last update to the Committee on the proposed GASB change was at the September 12, 2011, meeting, along with an update in the City Manager's Quarterly Business Report dated September 30, 2011. That update summarized the following:

> "In June 2010, the Governmental Accounting Standards Board (GASB) released a new accounting exposure draft intended to improve the visibility and quality of pension information contained in governmental financial statements.
>
> In summary, if the exposure draft is approved, the City would be required to record a liability on its Government Wide balance sheet associated with the unfunded liability, at a market value calculation, estimated at $200 million as of the June 30, 2010 valuation data. The City would be required to record accrued pension costs in a defined manner which will differ significantly from our actuarial funding schedule. The accounting standard may limit both the discount rate used to measure future liabilities and the amortization period in which actuarial gains and losses can be amortized. The cumulative impact of the proposed standard would significantly accelerate the recognition and volatility of pension expenses.
>
> While this standard is still in draft form, if approved, the new pension reporting standard will have some drastic impacts on future pension financial reporting and has not been universally embraced. A coalition of 21 issuers, public pension and

professional associations submitted a joint two-page comment letter, stating the draft represents “radical departure from long-held practice” and the proposal would significantly alter how state and local government account for pension benefits and create “much confusion.” Collectively, the groups – including the Government Finance Officers Association, the National League of Cities and the U.S. Conference of Mayors – said GASB should “clearly and specifically articulate” that the new accounting measures are not based on, and should not be used for, government pension funding and budgeting. Separately, the GFOA submitted a comment letter saying it “adamantly opposes” the Board’s proposal to “abandon” the ARC as the basis for measuring pension cost. Such a move “would mark a major step backward,” the GFOA said. In particular, the group noted, “the unfunded actuarial accrued liability is simply too volatile to display as a liability on the face of the financial statements.” The GFOA also said there was no “cause to jettison” the ARC “in favor of an alternative approach that promises little in the way of information of practical use to actual public-sector decision makers.”

On Thursday, May 3, 2012, GASB and CalPERS joined forces to provide an overview of changes that have taken place since last year. GASB has heard the criticisms from the professionals mentioned above and there have been changes to both the proposed GASB statement and <u>possible</u> changes by CalPERS as well.

Listed here are the more significant changes as discussed:

- Implementation will be effective fiscal years beginning after June 15, 2014, (FY 2014-15 for Newport Beach), a delay of one year from the original proposal. This was agreed upon to allow the professionals needed to conduct the additional actuarial valuations time to prepare, implement new systems and hire additional staff.
- GASB also agreed to change the time delay it would accept between actuarial dates and CAFR reporting. As proposed, GASB required a valuation dated no more than 24 months before the fiscal year end reported. After consideration of the time and volume of the number of valuations needed by relatively few professionals, GASB changed that requirement to 30 months.
- Blended Rate concept: GASB has not changed the concept of a blended rate for those trusts which are not fully-funded, to what they refer to as a more realistic earnings assumption. However, Alan Milligan expressed his concern for this calculation, stating it took a significant amount of actuarial time to calculate even one plan’s “blended rate.” GASB would not concede this issue, so CalPERS examined other alternative methods they could assume which would all but eliminate the need for a blended rate calculation. The changes considered are:

    - 30 year closed amortization (versus 30 year open)
    - 5 year closed asset smoothing with no corridor (versus a 15 year open with 20% corridor)

Mr. Milligan assured the crowd that these two assumption changes would not have a material impact to the participant's rates for possibly more than 30 years, giving agencies time to make other plan amendments. But these changes would eliminate the need to perform a blended rate calculation because it would bring the longer term asset values equivalent to what the GASB is proposing. This would require CalPERS Board approval; Mr. Milligan is recommending these changes to the Board in December, 2012. He also mentioned that this would re-align the unfunded liabilities for both funding (actuarial) and accounting (GASB) purposes.

CalPERS remains concerned about timing. Will they have the system changes ready? Will they be able to handle the sheer volume of requests? Will they meet employer's fiscal year end deadlines? Mr. Milligan said he was hopeful many challenges have been reduced but some remain.

GASB is still planning to issue the Statement in June, 2012. I asked Mr. Milligan when he would be ready to provide Newport Beach a valuation using the new statement requirements; he stated not before FY 2013-14. When the GASB recommended early implementation, Mr. Milligan just smiled and shook his head. I did meet with Mr. Milligan after his panel and told him I would be interested in being an initial implementer and he said he would keep that in mind.

CONCLUSION

We will continue to monitor these events and work with CALPERS and our professional organizations to prepare the City for this change. We will also be sure to be first in line at CalPERS to avoid the certain surge of requests that will be made right before June 30, 2014.

Prepared by:

/s/Tracy McCraner
Tracy McCraner
Finance Director