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“Moral Hazards” in GASB Accounting Rules

The National Conference on Public Employee Retirement Systems (NCPERS) has recently published a white paper titled “The Case for New Pension Accounting Standards.” The author analyzed the accounting rules that the Governmental Accounting Standards Board (GASB) applies to public pension systems and concluded that the current rules provide a sometimes misleading picture of the health of a pension system. He argues that consequences of important decisions are often not realized for years, or decades after the decisions are made. He illustrates several potential changes to the accounting rules that would provide information to better guide decisions made by policy makers.

Specific topics discussed include:

- Current rules provide for the calculation of a net pension liability by subtracting the current value of assets from an estimate of total liability. These numbers are known with varying degrees of accuracy and are based on numerous assumptions; combining them results in an approximate funding level. The author of the white paper refers to this as a “low-accuracy number”; however, benefit professionals would say that it is the magnitude and not the precision that should be the focus. The author argues that important business and political decisions should not depend upon the precision of this number, as he argues, they currently do.
- The promise of future contributions by the plan sponsor is not taken into consideration in the current GASB rules. Given that a public pension system is permanent and ongoing, that promise has a value that should be reflected. The author’s concern appears to be that future funding cash flows aren’t reflected in the current determination of funding level. While an ongoing plan is expected to receive future contributions, the plan is also expected to provide an increase due to future benefits earned.
- Under current rules, assets are valued at market value and there is no adjustment for the risk of the asset class. The author suggests that asset values should be weighted in inverse proportion to their risk. The author argues that the current accounting rules encourage plan sponsors to take additional risk in their pension plans without really understanding the full impact of that risk.
- Funded ratio is currently used as the primary indicator of a plan’s health. According to the author, a better indicator may be an estimate of an asset depletion date, using risk-weighted assets.
- Current rules give no acknowledgement to the economic strength of the plan sponsor in measuring the health of the plan. The economic strength of the plan sponsor is critical to understanding whether a system is in crisis.

Although there are no changes to the GASB accounting rules on the horizon, this paper presents some interesting considerations for public plan sponsors evaluating the overall health of their system. In the meantime, practitioners must make sure that public plan sponsors and policy makers understand the intent and limitations of the pension financials available before making benefit or funding decisions.

A copy of the white paper can be found at the following link: https://www.plansponsor.com/analyst-sees-moral-hazards-gasb-pension-accounting-standards/

If you would like to discuss these ideas and how they could impact your analysis of your plan, please contact Jim Ritchie at 443-573-3924.