

Newsletter

Upcoming Community Service Event—August 18, 2012

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V.S.A. Benavente Middle School

Team Up to Clean Up



Date: 08/18/2012
Time: 8am - 2:30pm



Supplies Needed:

- Light Blue, White, & Yellow Paint
- Paint rollers | pans | screens | brushes | tape | scrapers
- Large trash bags
- Rakes
- Water Blaster
- Mop head and handles
- Wax

The Association of Government Accountants
- Guam Chapter is looking for VOLUNTEERS!

The school community of V.S.A. Benavente Middle School is in need of your labor of love and cleaning supply donations.

The AGA will assist in cleaning and minor maintenance



For more information please see the Community Service Chairs—
Ariana Villaverde
(ariana.villaverde@gmail.com),
Josie Villanueva
(josiegu@gmail.com), and
Lourdes Perez
(guamperezlou@gmail.com).

Contact Ariana Villaverde (Ariana.villaverde@gmail.com) or Josie Villanueva (josiegu@gmail.com) for additional information.

President's Message

AGA Guam Chapter Officers PY 2012—2013



Jason Katigbak, MBA,
CFE, CPA, CIA, CGMA
President
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President-Elect
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**Immediate-Past
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Gloria Travis, CGFM
Secretary
gltravis@uqam.uog.edu

Hafa Adai AGA members and friends,

We had a busy month last July 2012, as we had three major events – the 11th Annual 5K Walk/Run, the Regional Chapter Officer Workshop (RCOW) and the 5th biennial Guam Professional Development Conference (PDC).

The 5K Walk/Run

On July 14, 2012, we had our 5K Walk/Run event. Proceeds will benefit:

1. the Herminia Dierking Scholarship - \$1,500 will be provided to four students from the University of Guam (two for the Fall 2012 and two for the Spring 2013 semesters); and
2. the Guam Chapter Scholarship - \$1,000 will be provided to four students from the Guam Community College (two for the Fall 2012 and two for the Spring 2013 semesters); and
3. other charitable organizations.

The RCOW

On July 16, 2012, the Chapter Executive Committee of the AGA Guam Chapter, together with the AGA Pacific Rim Regional Vice President (RVP), Robert Jeffrey (from AGA Japan) and Past RVP Doreen Crisostomo (from AGA Guam) facilitated the RCOW. The RCOW is the Chapter's strategic planning meeting wherein goals and strategies are developed and key performance indicators identified to ensure that our mission to foster financial government accountability through education is met, alongside providing membership value and giving back to the Island community. We have a strong team this year and the CEC is excited to get everyone involved activities that will benefit our Chapter as a whole.

The Guam PDC

From July 17-19, 2012, we had our three-day Guam PDC at the Hotel Nikko Guam which was attended by 136 participants from Guam, Saipan, Kosrae, Yap and other neighboring islands. This is the largest attendance so far, for our Guam PDC. The participants were welcomed by Governor Eddie Baza Calvo, Public Auditor Doris Brooks and AGA National Past President Dr. Billy Morehead.

On Collaboration

One of the many good things that happened during the RCOW was the introduction of the Chapter with the Association of State Military Controllers (ASMC). David Evans, Director of the Guam Field Office Naval Audit Services attended the RCOW. The Chapter would like to collaborate with in future educational and community service projects, similar to what we have been doing together with the Guam Society of CPAs. We are expecting exciting things to happen in the near future.

Our Immediate Goal

We would like to show our appreciation to the membership by providing you relevant and affordable educational events. I would like to encourage our members to take the CGFM exams. We have five scholarships for each program year which covers both registration and exam fees. If you need any exam preparation assistance passing the CGFM exams please contact our CGFM Chairperson and Co-Chairperson Jojo Guevara (jbguevara@portguam.com) and Frances Danieli (fdanieli@ghura.org).

and a Thank You...

All of these could not be possible without the generosity of our Sponsors and also the support of our AGA members who volunteered their time (and also brought along them their families and friends to help out). The lists of sponsor for our events are presented in our website aga.guam.net/gpdc and aga.guam.net/community_service. Please support their businesses and causes.

As J.K. Rowling famously said, "we are only strong as we are united." I encourage every member to take a leadership position and be part of the CEC. This is how all of us started and the Chapter provides everyone an opportunity to lead and grow in the process. Be involved and lead.

Again, if there is anything we can do for you to fully optimize the AGA experience, please feel free to contact me or any of our officers or drop us a message at agaguamchapter@yahoo.com or post a message in our website aga.guam.net.

Member News

Happy Member Anniversaries!!

Please welcome our newest member, Mrs. Jacqueline Mesa, from the Guam Department of Education (GDOE)! She is now part of the 172 AGA Guam Chapter members.

We would also like to congratulate the following members for their membership anniversaries:

1. Mrs. Lucy R. Awa (5 years)
2. Ms. Nancy Cueto (4 years)
3. Ms. Bobbie S. Howard, CPA (19 years)
4. Ms. Sihna N. Lawrence (2 years)
5. Mrs. Lucele D. Leon Guerrero (5 years)
6. Ms. Velma L. Naputi (5 years)
7. Ms. Rosa Q. Santos (5 years)
8. Mr. Garry Yeoh (1 year)

Job Announcement Management Analyst IV

GDOE is seeking qualified persons to fill the Management Analyst IV position. The job announcement's closing date is on **August 31, 2012**.

Minimum experience and training required:

1. One year of experience as a Management Analyst III or equivalent work and graduation from a recognized college or university with a Bachelor's in public or business administration, industrial management, or closely related field; or
2. Any equivalent combination of experience and training which provides the minimum knowledge, abilities, and skills.

For inquiries, please contact GDOE Personnel Services Division at 475-0496.

WANTED: GAIN Treasurer and Secretary



The Guam Animals In Need (GAIN) Board is looking for someone who has accounting knowledge and interested in joining GAIN to promote responsible pet ownership. The Board is also looking for a secretary. This is a great way to get involved and volunteer for the betterment of our community. Please contact Valerie Bock at 483-6455; valjbock@gmail.com; or GAINmembership@gmail.com for more information.

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Chapter Officers/Directors Program Year 2012—2013

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Taling Taitano, CGFM, CPA
Awards Chairperson

Llewelyn Terlaje, CGAP
Bylaws Chairperson

Jojo Guevara, CGFM
CGFM Chairperson

Frances Danieli, CGFM
CGFM Co-Chairperson

Rizalito Paglingayen
Chapter Auditor

Bobbie Howard, CPA, CGMA
Communications Chairperson

Ariana Villaverde
Community Service Chairperson

Josie Villanueva
Community Service Co-Chair

Artemio "Ricky" Hernandez
Early Career Chairperson

Zeny Nace, CGFM, CPA, CFE
Early Career Co-Chairperson

Rodalyn Marquez, CGFM, CPA, CGAP,
CGMA
Education Chairperson

Jason Katigbak, MBA, CFE, CPA, CIA, CGMA
Education Co-Chairperson

Jerrick Hernandez
Historian Chairperson

Rachel Field
Membership Chairperson

Garry Yeoh
Membership Co-Chairperson

Joy Bulatao
Newsletter Editor

Matthew Quinata
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Vincent Duenas, MPA
Programs Meeting Chairperson

Doris Flores Brooks, CGFM, CPA
Scholarship Chairperson

Christopher Wolseley, CA
Standards/Research Chairperson

Carmela Vi
Student Representative, UOG

Doreen Crisostomo, CGFM, Ph.D.
Webmaster



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Facebook:
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Member News

Congratulations!!



Each year, the National President-Elect with the Senior Vice Presidents for Regional Services, acknowledges enthusiastic leaders with awards that recognize their exceptional service to AGA. This year, Dr. Crisostomo was awarded the **Platinum AGA Regional Vice-**

President award. This award was presented at the 61st Annual PDC in San Diego, California. This is the highest award given out of 14 Regional Vice-Presidents. Senior Vice President Marsi Woody nominated Dr. Crisostomo for this award. Dr. Crisostomo was the Regional Vice-President of the Pacific Rim chapters (Guam, Hawaii, Northern Mariana Islands and Japan).



AGA Guam Chapter receiving the National President's Award from Dick Bunce for the **Guam Chapter Executive Committee Award** was received by Vince Duenas, Immediate Past President together with Gloria Travis, Co-Chair CGFM; Jason Katigbak, President; Rodalyn Marquez, Education Chair; Doreen Crisostomo, Past RVP Pacific Rim and Doris Flores Brooks, Scholarship Chair.



AGA Guam Chapter garnered the chapter **Certified Government Financial Manager certification award** for Group B. Gloria Travis, co-chair of the CGFM committee for program year 2011-2012 accepted the award from AGA National President Richard O. Bunce CGFM, CPA on July 30 at the 61st Annual Professional Development Conference in San Diego, Calif. The award was featured in the Guam Pacific Daily News newspaper on August 8, 2012.

CGFM Reminder



To retain the CGFM certification, all CGFM's must adhere to the AGA's Code of Ethics. In addition, to continue using the CGFM designation after their names, CGFM's must be in an active status.

To maintain your CGFM certification in an active status, you must:

1. Pay the CGFM renewal fee by the due date every year;
2. Complete at least 80 hours of continuing professional education every two years in government financial management or related technical subjects (within the designated two-year CPE cycle); and
3. Maintain and, if requested by AGA, provide detailed information on CPE hours completed.

The 80 CPE hours must be completed within the CGFM's two-year CPE cycle. The first CPE cycle starts on Jan. 1 of the year following the one when the CGFM designation was earned. The CPE requirements apply to all active CGFM's, whether employed or not and whether employed full- or part-time by a government or other organization.

Active CGFM's must complete a minimum of 80 CPE hours every two years to maintain their CGFM certification. While there is no minimum number of hours required to be earned each year, CGFM's are encouraged to earn CPE hours throughout their two-year cycle. For more info., visit http://www.agacqfm.org/cqfm/maintain/cpe_requirements.aspx

"Practical Tips on Taking the CGFM Exams" (right). The presentation was held by Jojo Guevara and Dr. Ron McNinch during the GPDC. The course had approximately 30 attendees.



Monthly Meetings

July 2012 Membership Meeting Minutes

The July General Membership Meeting was held at the Outrigger Guam Resort on Wednesday, July 25, 2012. Sponsors and volunteers of the 11th Annual AGA 5K Run/Walk were honored at this meeting for their contributions, hard work, and dedication to the event. This meeting was also the start of AGA's program year 2012-2013 under the leadership of Mr. Jason Katigbak. Mrs. Barbara Howard, AGA Guam Chapter's Membership Chairperson celebrated her birthday during the meeting as well.



Association of Government Accountants - Guam Chapter Condensed Financial Statements As of July 31, 2012

	<u>Chapter</u>	<u>Community</u> <u>Svc.</u>	<u>Prof.</u> <u>Develop.</u>	<u>Memo</u>
Assets	\$ 869	\$ 14,436	\$ 65,380	\$ 80,685
Liabilities	-	-	-	-
Net Assets				
Earmarked	-	2,982	12,889	15,871
Unrestricted	869	11,454	52,491	64,814
Revenues	\$ 4,327	\$ 9,613	\$ 64,060	\$ 78,000
Expenses	1,138	2,926	35,334	39,398
Increase (decrease) in	3,189	6,687	28,726	38,602
Beginning net assets	(2,320)	7,748	36,654	42,082
Ending net assets	<u>\$ 869</u>	<u>\$ 14,435</u>	<u>\$ 65,380</u>	<u>\$ 80,685</u>

August 2012 General Membership Meeting

Time and Date: 12:00 PM on Thursday, August 30, 2012
Location: Outrigger Hotel, Tumon, Guam
Topic: "Personal Accountability & Ethics in the Workplace"
Guest Speaker: Teresa McKay, CPA, CGFM, CMA
 Director of Defense Finance and Accounting Service
Lunch Fees: \$12 AGA Member and \$17 Non-member

Speaker Biography

Teresa (Terri) McKay was sworn in as the Director of the Defense Finance and Accounting Service (DFAS) on September 15, 2008.



**Teresa McKay, CPA,
CGFM, CMA
Director
Defense Finance and
Accounting Service**

Mrs. McKay leads the day-to-day accounting and finance activities of the Department of Defense (DoD). Each year, the agency disburses over \$608 billion by processing 171.7 million pay transactions for 6.6 million military personnel, federal civilian employees, military retirees and annuitants; 11.8 million commercial invoices; and 7.7 million travel vouchers and settlements. Responsible for 1,165 active DoD appropriations, DFAS is the trust fund manager for \$30.7 billion in foreign military sales and \$559.4 billion in military retirement and health benefit funds. DFAS employs about 12,000 DoD civilian and military personnel at 10 locations throughout the United States, Europe and the Pacific.

Mrs. McKay has served in a variety of previous assignments providing her a strong foundation for her current role. Mrs. McKay served as the DFAS Principal Deputy Director from August 2006 until she became the agency's director. While a military spouse, she was also a DFAS customer serving with the Defense Commissary Agency. In addition, Mrs. McKay was a DFAS employee in Columbus, Ohio and Arlington, Virginia, as well as a policymaker for DoD while serving as the Defense Department's Deputy Chief Financial Officer, the principal advisor to the Under Secretary of Defense (Comptroller)/Chief Financial Officer for accounting and finance matters.

Mrs. McKay earned her bachelor's degree from Ferris State University and her master's degree in business administration from Auburn University at Montgomery. Mrs. McKay is a leader committed to improving financial management through improved business processes and incorporating accounting, finance and internal control requirements for strong DoD end-to-end business processes. Mrs. McKay epitomizes the DFAS motto of Proudly Serving America's Heroes.

Local Events

11th Annual 5K Run/Walk Results

The AGA Guam Chapter celebrated its 11th Annual 5K Run/Walk with the theme of "Planting Seeds of Accountability" on Saturday, July 14, 2012 at the Chamorro Village in Hagatna. The organization had over 400 participants that day, generating proceeds close to \$6,000 to fund the Herminia Dierking and the AGA Guam Chapter Scholarships. The Scholarships will be awarded to eligible University of Guam and Guam Community College students. The race would not have been possible without the generosity of AGA members, supporters, and volunteers from public and private sectors and their commitment to "advancing government accountability" and transparency.

Male finishers were John Aquino, top male runner at 17:15, followed by second place winner Rico Julio Flores (17:27) and Gerald Asuncion (17:56) at third place. Alexandria Plant, was the first female runner to cross the finish line at a time of 19:43 Second was Rhea Macaluso, who finished in 20:53, followed by Joy Advincula in 22:35.

Help out: Drive aims for school uniform donations for Guam foster children



There are more than 200 children in the island's foster care services. These children are in need of individuals and families who are willing to open their homes -- and their hearts -- to provide the kind of care and safe living environment that every child should have. As of May, the island had just 32 licensed foster homes. Many more are needed and we urge those who can fulfill this need to provide more of these foster children with homes to do so.

As part of this effort, Frist Lady Christine Calvo and the Rigalu Foundation, launched the second annual Foster Kids Uniform Drive, which helps provide foster children with school uniforms, and we commend both for their continual efforts.

Residents can help out by dropping off used, clean uniforms that are in good condition at the Rigalu Foundation or by purchasing uniform vouchers purchases at the first lady's office at Adelup. The vouchers cost \$125 for a set of uniforms meant to last through the year, but any donation is welcomed.

To donate or volunteer to help support the Foster Kids Uniform Drive, or to learn more about how you can help foster children, foster families and the nonprofit groups that assist them, call 475-9475 or send email to rigalugam@gmail.com

For more upcoming community service events, please contact Ariana Villaverde at ariana.villaverde@gmail.com or Josie

Thank You 5K Volunteers!

- 1 Mark Palarca
- 2 Lalaine David Castillo
- 3 Leilani Dolor
- 4 Melissa Faculo
- 5 Marie Calvo Perez
- 6 Lou Perez
- 7 Jason Katigbak
- 8 Debbie Ngata
- 9 VitaFermo
- 10 Garry Yeoh
- 11 Renee Panguirigan
- 12 Marcia Briones
- 13 Carmen K. Santos
- 14 Pilar Pangelinan
- 15 Yuka Hechanova
- 16 Travis Carbon
- 17 Llewelyn Terlaje
- 18 Maripaz Perez
- 19 Vince Duenas
- 20 Rachel Field
- 21 Jocelyn Untalan
- 22 Joy Bulatao
- 23 Rodalyn Marquez
- 24 Jerrick Hernandez
- 25 Clariza Roque
- 26 Josie G. Villanueva
- 27 Nancy Cueto
- 28 Doreen Crisostomo
- 29 Barbara Molarte
- 30 Juliet Galeno
- 31 Noeme Jereza
- 32 Josephine Muescan
- 33 Noeme Tuazon
- 34 Rosalia Abonales
- 35 Nicetas Datugan
- 36 Merlita Azicate
- 37 Ariana Villaverde
- 38 Matthew Quinata
- 39 Justine Denise Calvo
- 40 Roke Martin Calvo
- 41 Isa Koki
- 42 Kyle Mesa
- 43 Norma Mangalona
- 44 Doly Dalmacio
- 45 Rizza Suarez
- 46 RG Panglingayan
- 47 JR Metadio
- 48 Richard Vida
- 49 Carol Guerrero
- 50 Marlene Mesa
- 51 Pik Man Lam
- 52 Danielle Anderson
- 53 Levonne Borja
- 54 Jerome Blas
- 55 Lolita Reyes
- 56 Bonnie Datuin
- 57 Guillian Berman
- 58 Leilani Garcia
- 59 Danilo Bilong
- 60 Gina Tudela
- 61 Michael Chan
- 62 Justin Alano
- 63 John Camacho
- 64 Johanna Camacho
- 65 Paula Cruz
- 66 Ms. Peggy Denny
- 67 Esperanza Carlos
- 68 Ashley Gaerlan
- 69 Kristian Dizon
- 70 Cheri Sumalpong
- 71 Jessica Cachola
- 72 Carmela Vi
- 73 Marie Garcia
- 74 Edward Brobesong
- 75 Jan Ronnie Vallarta
- 76 Nina Doromal
- 77 Ruren Clemente
- 78 Benadine Montague
- 79 Abegail Mina
- 80 Ms. Sheena Jose
- 81 Rechelle Dela Cruz

Local Events

11th Annual AGA 5K Run/Walk



2012 Guam PDC



July 2012 General Membership Meeting



GASB: Pension Reporting

How Would GASB Proposals Affect State and Local Pension Reporting?

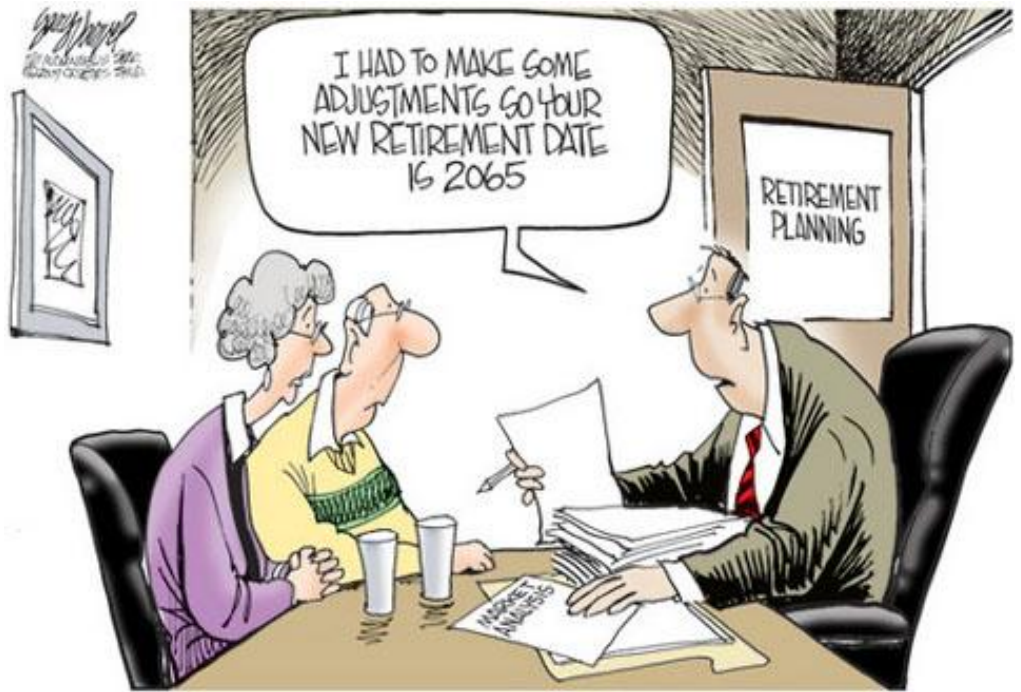
AGA Journal
Summer 2012 Vol. 61, No. 2

By Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz and Laura Quinby

Introduction

States and localities account for pensions in their financial statements according to standards laid out by the Governmental Accounting Standards Board (GASB). Under these standards, state and local plans generally follow an actuarial model and discount their liabilities by the long-term yield on the assets held in the pension fund, roughly 8 percent. Most economists contend that the discount rate should reflect the risk associated with the liabilities and, given that benefits are guaranteed under most state laws, the appropriate discount factor is closer to the riskless rate(1). The point is not that liabilities should be larger or smaller, but rather that the discount rate should reflect the nature of the liabilities; the characteristics of the assets backing the liabilities are irrelevant (2).

In 2006, GASB embarked on a project to review its accounting standards for pensions and propose changes as needed. The resulting proposals, outlined in two exposure drafts released for public comment in 2011, encompass a host of reforms pertaining to virtually every aspect of pension accounting(3). Three of the main proposals, however, pertain to the



valuation of assets and liabilities. First, plan assets would no longer be smoothed but rather valued at market. Second, liabilities would be discounted by a blended rate that reflects the expected return for the portion of liabilities that are projected to be covered by plan assets and the return on high-grade municipal bonds for the portion that are to be covered by other resources. Third, the entry age normal/level percentage of payroll would be the sole allocation method used for reporting purposes.

As it seems likely that the GASB proposals will soon become final standards, this brief takes a look at how the accounting changes will alter the funded ratios of

state and local plans. The first section reviews how plans currently value plan assets and employer liabilities and explains GASB's proposals. The second section presents aggregate funded ratios for the 126 plans in our Public Plans Database (PPD). The third section discusses some of the implications of the GASB proposals. The conclusion is that employers and plan administrators should be prepared for funded ratios reported in their financial statements to decline sharply under the new rules. But accounting changes do not alter the underlying fundamentals; \$1,000 owed to a retired teacher in ten years under current standards will remain \$1,000 owed in ten years under the new standards. So policymakers should not let new

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GASB: Pension Reporting

numbers throw them off the path of sensible reform.

Accounting Methods: Old and New

In the public sector, the rules for both reporting and funding public pension plans are set out in Governmental Accounting Standards Board (GASB) Statements 25 and 27 and their amendments(4). GASB, like its private sector counterpart, the Financial Accounting Standards Board, is an independent organization and has no authority to enforce its standards. Many state laws, however, require that public plans comply with GASB standards, and auditors require state and local governments to comply with the standards to receive a “clean” audit opinion. In addition, bond raters generally consider whether GASB standards are followed when assessing credit standing(5).

The financial well-being of a pension plan is frequently judged by its funded ratio. This measure equals plan assets divided by employer liabilities. Conceptually, the valuation of plan assets should be straightforward. In reality, most plans currently report funded status using a level that is smoothed, typically over a five-year period(6). This smoothing means that asset losses incurred in 2008 are still depressing funded ratios in 2011(7). Conversely, the full value of gains experienced in 2009 will not be recognized until 2014. In order to increase transparency in pension reporting, GASB is proposing that, for reporting purposes, plans abandon their actuarial smoothing methods in favor of a market valuation of plan assets.

Valuing pension liabilities raises two questions. What should be included in liabili-

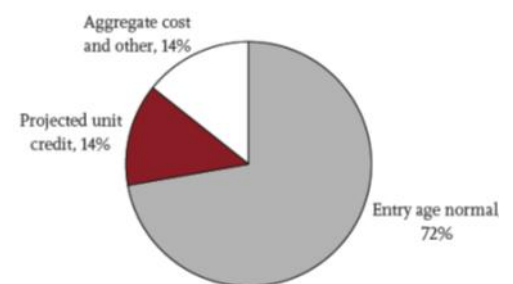
ties? And what discount rate should be used to express those liabilities in today's dollars? GASB currently defines liabilities in terms of the projected benefit obligation (PBO) liability concept. The PBO includes pension benefits to be paid to retired employees, benefits earned to date by active employees based on their current salaries and years of service, and the effect of future salary increases on the value of pension rights already earned by active workers. With regard to the discount rate, GASB 25 states that it should be based on “an estimated long-term yield for the plan, with consideration given to the nature and mix of current and planned investments...”

GASB's proposed change maintains the PBO liability concept, but alters the discount rate and the allocation method, proposing that the entry age/level percentage of payroll method be used for reporting purposes. Requiring that all plans use the same actuarial cost method is a change from the current arrangement under which plans that satisfy certain parameters can use the same cost method for funding and reporting purposes. As shown in Figure 1, 72 percent of plans currently use the entry age normal method, and aggregate cost plans are already required to report liabilities using entry age normal, so approximately 14 percent of plans will have to change their method for reporting.

Under the new discount method, each plan will project the number of future years in which assets on hand, investment returns, and certain future employer and employee contributions will be sufficient to pay annual benefit payments(8). The payments made in those years are discounted by the expected return on assets. Meanwhile, benefit payments that occur in years

after assets have run out will be discounted by the high-grade municipal bond yield. The new blended rate maintains the current link between liabilities and the assets used to pay for them; so long as the liabilities are projected to be funded, they are discounted by expected returns. Once they become unfunded, they are on the same footing as general obligation debt and are discounted by the municipal bond rate.

FIGURE 1. ACTUARIAL COST METHODS USED BY STATE AND LOCAL PLANS, 2010



Impact of Changes in Accounting on Funded Ratios

In order to demonstrate the impact of the proposed accounting changes on state and local funded ratios, this section proceeds in two steps. First, it presents funded ratios based on current GASB standards and funded ratios calculated using the market value of assets. Then, it combines market assets with liabilities discounted by the blended rate to demonstrate the full impact of GASB's proposed changes.

Immediately recognizing asset gains and losses results in a funded ratio that clearly demonstrates the degree to which plan funding is tied to the fate of the stock market. Figure 2 compares aggregate funded

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GASB: Pension Reporting

ratios for the 126 plans in the PPD calculated over time using actuarial versus market assets. It is clear that actuarial funded ratios lag market ratios. Market assets were lower than actuarial assets in the early 2000s as gains from the late 1990s were still present in actuarial values and losses from the 2001 dotcom bubble had not yet been fully accounted for. The picture reversed between 2005 and 2007, when market assets reflected gains that had not yet been fully accounted for in the actuarial measures. The 2008 financial crisis caused an enormous decline in market assets and a 18-percentage point drop in funding, whereas actuarial assets only declined by 5 percentage points. In contrast, 2010 funded ratios using market assets increased by 3 percentage points, while funded ratios using actuarial assets were still dropping. But the bottom line is that the aggregate funded ratio using market assets was only 67 percent in 2010 compared to 76 percent using actuarial assets, so policymakers should be prepared for a sharp decline in funding if GASB introduces this change.

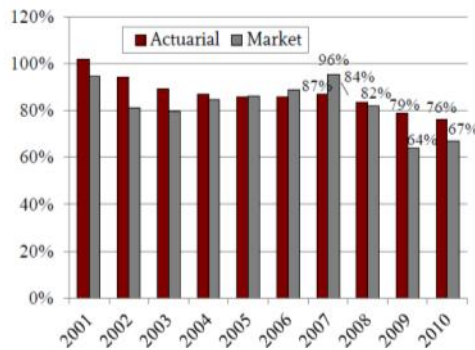
The next step is to estimate how funded ratios would change if liabilities were discounted using a blended rate of return. This exercise requires knowing the underlying stream of benefit payments owed by the plan in future years. Public pensions typically do not disclose this information, so the benefit stream must be re-engineered based on data from actuarial reports on the age, salary, and tenure of the workforce, as well as assumptions regarding retirement, separation, and mortality(9).

With the stream of projected benefits in hand, the task is to project the portion of

that stream that will be covered by plan assets and the portion that will be covered by other resources. Projected assets depend on two factors – contributions and investment returns. Contributions, in turn, consist of two components – normal cost and amortization payments(10). In determining how much sponsors will contribute in the future, GASB recommends looking at the percent of Annual Required Contributions (ARC) paid in the past. We interpreted the past to be the last ten years (11).

In terms of investment returns, GASB pro-

FIGURE 2. AGGREGATE FUNDED RATIOS FOR STATE AND LOCAL PLANS USING ACTUARIAL AND MARKET ASSETS, 2001-2010



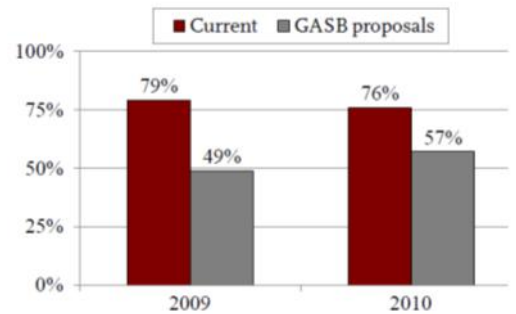
poses to use the plan's long-run expected return.

With flows of projected benefits, government and employee contributions, and investment returns, it is possible to calculate the date when assets are exhausted. All benefits payable in years prior to the exhaustion date are discounted using each plan's assumption regarding the expected return on assets. Benefits payable after the run-out date are discounted by

3.7 percent – the current yield on high-grade municipal bonds(12).

Figure 3 compares the funded ratios cur-

FIGURE 3. AGGREGATE FUNDED RATIOS FOR STATE AND LOCAL PLANS: CURRENTLY REPORTED VERSUS GASB PROPOSALS, 2009-2010



rently reported with our estimates of what these ratios would have looked like under GASB's current proposals for 2009 and 2010. Results for individual plans and our estimates of the combined discount rate that will result from GASB's new procedure were recorded(13). The bottom line is that the headline number will decline in 2010 – the latest year for which data are available – from 76 percent to 57 percent(14).

Implications of GASB's Proposals

GASB lays out the rationale for its blended rate in the exposure drafts. GASB's argument is that, while the expected rate of return is appropriate for discounting liabilities backed by assets, liabilities not covered by assets fall to the sponsoring government and there should be discounted by the index rate of high-yield, tax-exempt, 20-year general obligation bonds(15). The argument is at odds with the economist's view

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that the discount rate should reflect the riskiness of the liabilities, irrespective of how the liabilities are funded. That debate, which has gone on for years, will not be settled in a brief. Instead, the following section discusses implementation issues, interpretation challenges, and the implications for the ARC associated with GASB proposals.

Implementation Issues

The main implementation problem with GASB's proposed blended rate is that it requires a complicated calculation based on a number of assumptions. The determination of the portion of benefits funded requires a projection of plan assets available each year to cover promised benefits. The asset projection would include assumptions not only about plan returns but also about future contributions from the government and from employees(16). These contributions may or may not come to pass. One can imagine extended disputes about the validity of the underlying assumptions.

Interpretation Challenges

Economists use pension data generated under GASB's standards to address three main economic issues: 1) basic comparisons of pension finances across states and over time; 2) the impact of pensions and other post-employment benefits (OPEBs) on government budgets and borrowing capacity; and 3) the relative compensation of public sector workers. In order to produce useful analysis, the data need to provide meaningful measures of government obligations and be consistent across states and localities and over time. The new GASB discounting proposal fails

on a number of counts.

- It creates a liability number with no theoretical underpinnings in terms of the potential burden on states and localities. It makes no theoretical sense for two identical streams of benefits to have different values based on the funded status of the plan. Having the present discounted value of liabilities depend on both the long-run expected rate of return and on the funded status makes the numbers even more difficult to interpret and difficult to adjust for alternative returns than the current liability numbers.
- It makes comparisons across states and localities impossible because the denominator of the funded ratio will reflect the value of the assets. Moreover, a change in the funded status of a given plan will be attributable to both the change in assets and the impact of that change on the value of liabilities. This feedback complicates a systematic analysis of why funding has improved or deteriorated.

- It creates a new "projected" funded ratio – the projected assets divided by the liability calculated at the blended rate. This concept has the potential to compete with the traditional funding ratio – assets divided by liabilities – and create unnecessary confusion.

Implications for the ARC

GASB's proposals will remove the ARC – the percent of payroll required to cover current service costs and amortize the unfunded liability over a maximum of thirty years – from the measurement of pension obligations and costs. In its place plans will either report an actuarially determined

contribution or a statutory contribution. Those that report an actuarially determined contribution will provide information on the underlying actuarial assumptions and methods used. However, there will no longer be any GASB guidelines regarding acceptable parameters, which will make comparisons between plans difficult. Plans in states with statutory contribution rates will no longer be required to calculate an ARC(17). This change not only represents a loss in analysts' ability to assess how close plan contributions are to those required to keep the system on track but also creates an escape valve that states could use as ARCs rise beyond reach: introduce a statutory rate and dispense with ARC calculations(18).

Conclusion

The purpose of this brief is not so much to re-argue the case for using a discount rate based on the nature of the liabilities irrespective of how those liabilities are funded, but rather to provide a "heads up" in the event that the GASB proposals are adopted. The proposals will sharply reduce the reported funded levels of public sector plans. It would be unfortunate if the press and politicians characterized these new numbers as evidence of a worsening of the crisis when, in fact, states and localities have already taken numerous steps to put their plans on a more secure footing. Reforms need to be done carefully and thoughtfully, remembering that pensions are an important part of the total compensation of public sector workers. Policymakers should not let new numbers throw them off course.

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Endnotes

- 1 See Bader and Gold (2007); Brown and Wilcox (2009); Gold (2009); Munnell et al. (2010); and Novy-Marx and Rauh (2008, 2009, and 2011).
- 2 The analysis of choice under uncertainty in economics and finance identifies the discount rate for riskless payoffs with the riskless rate of interest. See Gollier (2001); and Luenberger (1997). This correspondence underlies much of the current theory and practice for the pricing of risky assets and the setting of risk premiums. See Sharpe, Alexander, and Bailey (2003); Bodie, Merton, and Cheeton (2008); and Benninga (2008).
- 3 Governmental Accounting Standards Board (2011a and 2011b).
- 4 Statement No. 25 is titled "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans." Statement No. 27 is titled "Accounting for Pensions by State and Local Governmental Employers." The provisions of GASB 25 and 27 became effective one year later.
- 5 U.S. Government Accountability Office (2008).
- 6 The smoothing method is not a simple five-year average, but rather a gradual recognition of investment gain/loss experienced by a plan relative to its expected return on assets.
- 7 See Munnell et al. (2011a).
- 8 Only those contributions that are de-signed to fund payments for current employees, both active and inactive, would be included.
- 9 The methodology for first re-engineering the benefit stream and then re-discounting this stream is adapted from the procedure used to estimate trust fund run-out dates under the termination framework described in Munnell et al. (2011b).
- 10 The exercise is complicated by the fact that GASB's proposal puts each of these components over a different definition of payroll. Future normal cost contributions are made for current members only, whereas future amortization contributions are made for both current members and new hires. GASB's approach of using two different payrolls reflects what most plans currently do. Whereas the normal cost for current members is funded over the members' worklives, amortization of unfunded liabilities occurs over a longer period, which includes the hiring of new workers.
- 11 In January 2012, GASB tentatively agreed to include guidance in the final Statement that would refer to the past five years of contributions as a key factor to be considered in this application. See Governmental Accounting Standards Board (2011c).
- 12 Bloomberg (2011).
- 13 This rate equals the single number that could be used to discount the benefit stream to produce an equivalent liability to the multi-step process described above. The results were sent to each of the 126 plans for review.
- 14 Of course, these estimates hinge on the contribution assumption. Actuaries have suggested that a crossover point may never be reached if plans make actuarially determined contributions that are based on a closed amortization period.
- 15 Governmental Accounting Standards Board (2011a, 2011b, and 2011c).
- 16 Interestingly, FASB considered and rejected such an approach not only because the contribution assumptions are so uncertain but importantly because it would "unnecessarily complicate the recognition and disclosure requirements" (Financial Accounting Standards Board, 1985).
- 17 Governmental Accounting Standards Board (2011a and 2011b).
- 18 Relying on statutory rates raises potential concerns – they may not be set to adequately reflect a plan's funding needs and their static nature makes it more difficult for a plan's funding strategy to respond to changing conditions.

For plan-specific analysis, a full description of the methodology underlying the calculations, and additional references, see <http://crr.bc.edu/working-papers/how-would-gasb-proposals-affect-state-and-local-pension-reporting-2/>.

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