Public Pensions Face More Pressure Under Accounting Rules

By Darrell Preston and William Selway on June 25, 2012

State and local pensions struggling after years of underfunding and weak investment returns may look even worse under new rules that will limit accounting techniques that hide the extent of liabilities.

The Governmental Accounting Standards Board, which establishes requirements for state and local government financial reporting, will alter how liabilities are calculated and how assets are reported without affecting how much is actually owed to retirees. Under the new guidelines, to be adopted today, pensions in Illinois, New Jersey, Indiana and Kentucky may have less than 30 percent of assets needed for promised benefits, according to the Boston College Center for Retirement Research.

“We’re expecting some troubled credits to look worse,” Richard Ciccarone, managing director of McDonnell Investment Management LLC in Oak Brook, Illinois, which oversees $8 billion in municipal securities, said in an interview. “That will cause some shock and awe.”

States and cities rattled by the Wall Street credit crisis four years ago have been under pressure to put more money into their retirement funds and claw back benefits amid investor speculation that pension shortfalls might lead to insolvency.

Assumptions Vary

The magnitude of the shortfalls ranges from $900 billion to more than $4 trillion, depending on the assumptions used to account for benefits that aren’t due for decades.

New criteria set by the Norwalk, Connecticut-based panel will “substantially improve” the accounting and financial reporting of public pension systems, according to a statement by the board.

The rules are aimed at limiting accounting techniques that mask liabilities. That will provide a clearer picture of the size and nature of the obligations, Robert Attmore, chairman of the board, said in a phone interview.

“We say it’s a more accurate picture of the financial position,” he said. “The new standards will provide better information. The ultimate goal is to make things more transparent.”

Long-term promises of defined pension benefits will be categorized as a liability on financial statements for the first time, to “more comprehensively and comparably measure the annual cost,” according to the board. The changes also alter accounting for future benefits and projections of investment returns.

Annual Contributions

The new rules will take away a key tool for evaluating pensions, the so-called annual required contributions -- how much needs to be put into a fund to maintain adequate financing, said Stephen Gauthier, director of technical services for the Government Finance Officers Association in Chicago.

“What people want to know is what do they need to do,” Gauthier said in a telephone interview. “Are they meeting or not meeting their funding obligations?”

Pensions will still have to disclose some information about contributions that need to be made in comparison to what they actually contribute over 10 years, John Pappas, a spokesman for the accounting board, said by e-mail.

The changes may prompt governments to put away less than they should to keep retirement systems sound, while providing fodder for political opponents of public-sector unions, said Harold Schaitberger, the general president of the International Association of Fire Fighters.

‘Unfunded Liability’

“The new provisions will have the effect of increasing the unfunded liability when the actual numbers won’t change,” Schaitberger said. “It will give a view of the system that’s going to play into the hands of those -- at the risk of overstating it -- who have been waiting for this moment.”

Kinney Poynter, executive director of the National Association of State Auditors, Comptrollers and Treasurers, in Lexington, Kentucky, said putting more liabilities on the balance sheets means “legislators will see it and have to deal with it.

“The general public will see it as a more accurate reflection of the liability that already exists,” Poynter said.

The changes represent an attempt to strike a middle ground in the debate over using expected investment returns when reckoning the size of the liabilities, said Alicia Munnell, the director of Boston College’s Center for Retirement Research.

Meet Halfway

“They think they’re trying to meet people halfway and what you’re really getting is sausage,” she said. “The numbers will change, but the reality hasn’t changed at all.”

Pensions will still be able to cut their reported liabilities by assuming higher returns on their investments, said Andrew Biggs, an analyst with the American Enterprise Institute.

As a result, he said, funds that pour money into risky investments with potentially higher payoffs will look more sound than retirement systems playing it safe.

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