Accounting Changes Proposed for State, City Retiree-Benefit Plans

States, Cities Would Have to Add Liabilities to Balance Sheets, Many Plans Could Look Weaker

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Updated June 16, 2014 6:06 p.m. ET

States and cities could be forced to report at least half a trillion dollars of additional costs on their books under proposed rules that would shine a harsher light on the growing expense of retired workers' health insurance and other benefits.

The proposals, unveiled Monday by an accounting-standards group, would require state and local governments to add retiree-benefit promises to their balance sheets, making governments' overall financial position appear worse. In addition, many governments would have to change the way they calculate their benefit obligations in a way that could make their shortfalls appear bigger than they do now.

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The move by the Governmental Accounting Standards Board is intended to give taxpayers, policy makers and investors more information about the toll that retirees' promised benefits will take on states' and cities' finances. The proposals wouldn't require governments to raise more money to pay for retiree benefits, and they wouldn't force governments to change the level of benefits they provide.

"It will provide a better picture of the cost and liabilities for these benefit promises," said GASB Chairman David Vaudt.

The proposals come as governments grapple with rising costs for current and retired workers. Some states have been racked by legislative battles over how to trim costs. Several municipalities, including Detroit and Stockton, Calif., have filed for bankruptcy protection in recent years amid retiree-benefit burdens, among other issues.

Some municipal-bond investors applauded the GASB proposal. The rule would show "how good a shape or how bad a shape the issuer is in," said Marilyn Cohen, president of Envision Capital Management, a Los Angeles fixed-income money manager.

According to a Standard & Poor's report last fall, California and New York are among the states with the highest level of unfunded retiree-benefit obligations. California, for instance, in March said it had $64.6 billion in unfunded health benefits for state retirees. A spokesman for the New York state comptroller's office said, "We are reviewing the proposals." A spokesman for the California state controller's office had no immediate comment.

The GASB proposals, which the board approved last month, are subject to public comment and possible reconsideration before the board adopts them. The board is accepting public comments through Aug. 29, and plans to hold public hearings on the proposals in September in New York, Illinois and California.

The proposals follow similar changes GASB made in 2012 to state and local governments' disclosure of pension obligations, which also were intended to give taxpayers and investors more information but would make pension funding appear weaker.

According to the Center for Retirement Research at Boston College, a group of 150 public-employee pensions that were 72%-funded in 2013, meaning their assets were 72% of their obligations, would have been only 65%-funded under the revamped rules.

The pension changes are only now fully taking effect, and Mr. Vaudt said it is too soon to tell what impact they will have in pressing state and local governments to address their pension underfunding.

Still, with the new retiree-benefit proposal, some investors believe the added visibility for benefit-plan underfunding could add to pressure on governments to address the problem. "This is a major step toward getting these funded," said Matt Fabian, a managing director for Municipal Market Advisors, a Concord, Mass., research firm. "This is a problem that is as big as pension funding. Investors are clamoring for this."

Moody's Investors Service estimates states' total unfunded retiree benefit liabilities at $530 billion, which would be added to governments' balance sheets under the GASB proposals. Currently, the liabilities are reported only in the footnotes to government financial statements. The figure doesn't include local governments' benefit obligations, for which it is difficult to get an accurate total.

Another important change would revamp the way the obligations are valued. Most governments haven't yet committed money to pay for their retiree benefits and work on a "pay as you go" basis. But to the extent that governments haven't funded their benefits, they would have to measure the current value of those benefits using a lower interest-rate assumption. That has the effect of increasing the obligations' current value and widening the plans' funding shortfalls.

Marcia Van Wagner, a Moody's analyst, is cautious about whether any changes in reporting retiree benefits will lead to more pressure on governments to fund their benefit plans. Governments have already been trying to trim benefits and reduce costs because of their overall financial problems, she said, not specifically because of any changes in accounting rules.

"I'm not sure that accounting standards really drive the policies of state and local governments," she said.

Even Ms. Cohen questions whether the changes will help put more pressure on governments about funding their retiree benefits. "In theory, yes. In actuality, we'll have to see."

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