

Insights

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By clicking on a heading in the Bookmark section on the left, you will go directly to that subject.

Auditing

Pension Bill Changes Plan Funding and Administration

The Pension Protection Act of 2006 recently was passed by Congress and signed by the President, making extensive amendments to the benefit provisions of the Internal Revenue Code and to the Employee Retirement Income Security Act of 1974. The bill's primary purpose is to replace the current funding requirements for defined benefit pension plans with new, more rigorous standards and permanently replace the 30-year Treasury bill interest rate with a rate based upon long-term investment-grade corporate bonds. The good news is that the bill also increases the allowable contributions to defined benefit plans, making it easier for a sponsor to fund the plan in a profitable year.

Beginning with the 2008 plan year, the bill would completely replace the current funding rules for single-employer defined benefit pension plans with a new set of rules for determining minimum required contributions. Under the bill, the minimum required contribution of a plan sponsor to a single-employer defined benefit plan for a plan year would be the amount required to fund the benefits that accrue in that year. This means the amounts earned due to services performed in that year and any increases in accumulated benefits attributable to changes in salary for that year. In addition, a contribution would be required to amortize over seven years any "funding shortfall." Plans that are seriously underfunded would face accelerated contribution requirements. A "funding shortfall" is the difference between the plan's assets and its obligations.

Among its many provisions, the bill also would:

- Impose new benefit limits on seriously underfunded plans;
- Limit the funding (including through a "rabbi trust") of non-qualified plan benefits available to executives of sponsors of underfunded plans;
- Change the premiums that the sponsors of underfunded plans must pay to the Pension Benefit Guaranty Corporation to insure a minimum level of benefits to their participants;
- Extend certain tax law provisions for raising annual contributions limits for retirement savings;
- Establish a safe harbor for employers to provide investment advice to help employees manage their 401(k) accounts;
- Promote automatic enrollment of employees in 401(k) plans;
- Clarify the legal standing of cash balance pension plans; and
- Revise a number of the prohibited transaction rules to deal with plan participation in block trades brokered by a party in interest, transactions with parties in interest through regulated electronic communications networks, and certain cross-trading and foreign exchange transactions.

The bill's provisions will have significant effects on the administration of benefit plans. Plan sponsors will want to review their existing plans for compliance. Many employers may see an increase in their funding obligations.

Public Sector

Concepts Statement Proposed

The Governmental Accounting Standards Board (GASB) uses Concepts Statements in developing standards of governmental financial reporting. Concepts Statements identify the objectives and fundamental principles of financial reporting that can be applied to solve numerous financial accounting and reporting issues. Concepts Statements are not used to prescribe the financial reporting standards that apply to a particular item or event.

To develop a conceptual framework appropriate for the government environment, the GASB decided to define the most basic building blocks of financial reporting and therefore recently proposed its fourth Concepts Statement, *Elements of Financial Statement*. This proposal defines the seven elements (fundamental components) of historically based financial statements of state and local governments. A central feature of each of the proposed definitions of elements is a *resource*, which is an item with a present capacity to provide service.

Per the proposal, the elements of a statement of financial position would be defined as follows:

- *Assets* are resources the entity presently controls.
- *Liabilities* are present obligations to sacrifice resources or future resources that the entity has little or no discretion to avoid.
- A *deferred outflow of resources* is a consumption of net resources by the entity that is applicable to a future reporting period.
- A *deferred inflow of resources* is an acquisition of net resources by the entity that is applicable to a future reporting period.
- *Net assets* are the residual of all other elements presented in a statement of financial position.

The elements of the resource flows statements would be defined as follows:

- An *outflow of resources* is a consumption of net resources by the entity that is applicable to the reporting period.
- An *inflow of resources* is an acquisition of net resources by the entity that is applicable to the reporting period.

The proposed Concepts Statement is available for comment until November 17, 2006 at http://www.gasb.org/exp/ed_elements_financial_statements.pdf.

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