

COMMENTARY

Granof: Texans should call legislators to account for rule change

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Suppose that a few years after major accounting scandals in which corporations were accused of false and misleading reporting, the Legislature passed a law that requires all Texas governments to keep huge liabilities off their balance sheets. Weird? That is precisely what bills pending in both the Senate and House would do. HB 2365 and SB 1102 mandate that Texas governments prepare their financial statements in violation of generally accepted accounting principles.

In 2004, an independent national governmental accounting board ruled that state and local governments throughout the United States should report on their financial statements the costs for medical and related benefits that their employees will receive when they retire. The rationale was that these benefits are not gifts; instead, they are a form of employee compensation. Just as governments are required to report pension obligations, so too should they report obligations for other forms of post-employment compensation.

The new rule, effective for the largest governments within the next year, will have absolutely no effect on the actual amount to be paid to retirees. It will not affect the substantive obligations of the governments. However, several legislators and state and local government officials object to the rule and introduced legislation that prohibits governments from adhering to it.

Opponents of the rule contend, quite correctly, that the obligations of Texas governments to pay retirement benefits are not legally binding. However, that argument is irrelevant. Accounting does not look to legalisms to establish when an obligation must be reported. It is sufficient that one party indicates its intention to make a payment and the other party expects to receive it.

Opponents also argue that the liability for the benefits is difficult to measure. That, too, is correct, but it is all the more reason why governments should be forced, not only to measure the obligation, but to report it. To be sure, the liability to be reported may be merely an actuarial estimate. Perhaps a government will estimate the liability at \$50 million when the actual liability turns out to be \$60 million. But \$50 million is a great deal closer to reality than zero, which is the amount that state officials would like to see reported.

Opponents also maintain that, by disclosing the liability, governments will be encouraged to cut back on the benefits. That argument is nothing more than an admission that if the public knew what health benefit programs actually cost, then the governments would eliminate or modify them. Indeed, the very reason for reporting the obligations is that disclosure subjects the benefits to scrutiny. It encourages governments to decide whether they are in the public interest and, if they are, to figure out ways to pay for them.

Contrary to what some believe, bond rating agencies will almost certainly not lower ratings of Texas governments because they report their retirement obligations. Quite the contrary. The rating agencies are well aware of the liabilities, so the real risk is that they will eventually downgrade the ratings of those governments that refuse to acknowledge them. Governments in the other 49 states will be reporting liabilities for post-employment benefits. Can anybody seriously argue that Texas governments will gain fiscal credibility by implicitly claiming that they alone are obligation-free?

The pending legislation is especially pernicious because it will undermine the authority of the independent accounting board to objectively establish standards. Each state will then be free to set its own rules. Just imagine how reliable financial statements will be when it is the politicians who determine our accounting principles.

Texans, more than anyone, should be sensitive to the importance of fiscal transparency. Bad accounting happens. The last thing we need is for our state to legislate it.

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