



**Public Pension Financial Forum
c/o Municipal Employees' Retirement System**

1134 Municipal Way

Lansing, MI 48917

October 13, 2011

Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Subject: Project No. 34-E

Dear Board and Staff:

The Public Pension Financial Forum (P2F2) is pleased to have the opportunity to respond to the Government Accounting Standards Board (GASB) Project No. 34-E, Exposure Draft (ED) document on "Accounting and Financial Reporting for Pensions an amendment of GASB Statement No. 27".

P2F2 was formed in 2004. The purpose of this organization is to promote excellence in public pension plan financial operations, provide educational programs of current interest to the membership, promote the exchange of ideas concerning financial operations and reporting between public pension plans, and to foster sound principles, procedures and practices in the field of public pensions related to the financial operations of such plans. Membership is open to any finance employee of a public pension who supports the purposes of P2F2. The organization currently has 179 members representing 114 plans, offering defined benefit, defined contribution and hybrid plans.

We would like to thank GASB for considering changes to the pension accounting and financial reporting standards. P2F2, as stated in our mission statement, is also striving for sound principles, procedures, and practices. We agree with GASB for the need of increased transparency and accountability for the plans, employers, and plan sponsors. However, we believe that the proposed approach described by GASB is complex and will lead to unnecessary volatility, thus greatly reducing the decision-usefulness of the financial statements. We believe the pension expense number will be extremely difficult to explain and how it will be useful for decision-making is unclear. In addition, we believe that the proposed statements would place an undue and onerous burden on staff at pension plans and result in a significant increase in

expenses for actuarial and potentially audit services. While the ED approach may have theoretical appeal, we believe it will add unnecessary complexity which will make the information difficult to understand and communicate to many financial statement users.

In this comment letter we will provide a recommended alternative approach, list the major areas of concern with the current ED, and suggest a simplified approach to the proposed allocation methods.

Recommended Alternative

For employers (or component units) required to display a net pension liability (NPL) on their financial statements, we believe any method of allocation is arbitrary and that the employer's information should be disclosed rather than recorded as an unfunded liability. This treatment is consistent with the proposed standards recently released by the Financial Accounting Standards Board. We are concerned that the proposed NPL for the employer is not sufficiently reliable or verifiable when allocated back to the employer. Even at the collective level, a strong argument can be made that the total pension liability (TPL) is not sufficiently reliable, as there are a number of actuarial cost methods and a number of assumptions used in the calculation of the TPL. It has been estimated that the unfunded liability of public pension plans could be in the range of \$350 billion to \$3 trillion dollars.

In addition, most employers in cost-sharing multiple-employer plans have no ability to set benefit or contribution levels, but are statutorily required to participate in the plan with no ability to easily exit the plan. In this sense, the plan is akin to Social Security and may actually be a Social Security replacement plan for an employer in some jurisdictions. It has also come to our attention that the law or governing rules in some jurisdictions make it clear that it is not ultimately the liability of the employer.

It is for these reasons that we recommend that the employer prominently display the words "contingent pension liability" on the financial statements and refer to a note disclosure. Our recommendation is to expand the current GASB 27 note disclosure to include the collective NPL, collective funded ratio, collective NPL plus or minus 1% change in the discount rate, collective covered payroll, collective contributions, number of active members at the collective level, actuarially recommended contribution, current and future contribution rates, employers' covered payroll, and employers' contributions for the plan's fiscal year.

Current ED Approach - Major Areas of Concern

Reporting at Employer Year-End – Multiple employer plans, and even some single employers with discrete component units, will have to report quarterly or monthly to match the year-ends of their contributing employers. The multiple year-ends of the plan's employers will cause significant issues and substantial costs as described below:

October 13, 2011

Asset Valuation – Pension plans will need to alter their processes and procedures to be able to value assets on a more frequent basis. We are most concerned with the valuation of private equity and real estate assets which are reported on a quarterly basis, at best, and often report with a significant time lag. Plans will have to re-evaluate the approach they have taken with accruals and allocation of expenses, which for many plans take place on an annual basis.

Plan Disclosures – Pension plans will need to prepare their plan's asset-related note disclosures for each employer year-end to determine if any significant changes have occurred, and if so, communicate these changes to the hundreds or thousands of employers for inclusion in their financial disclosures (Paragraph 35, 68 & 88). This review would need to include disclosures related to derivatives, interest rate sensitivity, credit, foreign currency, securities lending, deposits, and custodial credit risk. Additionally, it is not clear to what extent subsequent events at the plan level would need to be disclosed by contributing employers.

Collective Level Reporting – We are concerned that the collective level reporting of the plan will not be consistent across all employers as it is based on the employer year-end and not the plan year-end. Additionally, the sum of the employers' financial data on the pension will never equal the plan's collective total if reported with the employers' multiple year-ends. We believe this will add confusion for the users of the plan's financial data if the employer has a different set of disclosures and may force the plan to issue unaudited collective level data.

Audit Concerns – We are concerned that this information will need to go through some sort of audit procedures to satisfy the needs of our hundreds or thousands of employers' auditors. Obviously, this will burden the plans' financial staffs and add significant audit fees.

Actuarial Concerns – The proposed requirements within the ED will require a significant increase in actuarial fees as well as added plan administrative staff time to provide the actuaries with the necessary data to prepare the liability roll-forward schedules. Additionally, we are concerned whether the actuarial community has the ability to handle the increased workload brought on by this ED given the short time frame for implementation.

Information Technology – Plans systems and processes have been designed around an annual financial reporting deadline; a move to a more frequent or monthly reporting deadline will require significant changes to those systems which will take additional time and increase costs.

Timeliness of Plan Reporting – Due to the typical time delays in recording private equity and real estate funds and in developing the actuarial liability roll-forward schedules, we

are concerned that the plans will not be able to provide the necessary information to the employers required by the ED in a timely manner.

Data Availability – We believe that most plans do not capture the data at a level required to fulfill the requirements of this ED.

Employer Level Reporting – Pension plans process data at a level to facilitate the payroll systems of the employer reporting agencies which does not necessarily match the financial reporting units of an employer's government. For example, a plan could receive contribution and member demographic data from one reporting agency that includes a primary government and multiple discrete component units which have different year-ends. The plan would not be able to allocate financial information or demographic data for the employer. This in turn will require the employer to perform a second allocation for each financial reporting unit.

Special Funding Situations – Pension plans may not be aware of all special funding situations that occur at the employer level which are consolidated when submitting contributions to the plan. In analyzing this ED, some plans have found conditional and unconditional special funding arrangements that occur prior to the submission of contributions to the plan. As in the example above, this situation will require additional allocations at the employer level, not to mention significant front-end research to uncover all possible special funding situations.

Classes of Employees Covered – This seemingly simple disclosure becomes very complex for a system that has multiple defined benefit, defined contribution, and hybrid plans and the respective portability between plans. The unique cases and questions are endless and we are struggling with the definition of active, inactive, and retired when one looks at the plan-level data versus the employer-level data. Additionally, as plans do not collect data at the financial reporting unit level (primary government or discrete component unit), the plans or employers may not have a viable method to accumulate this information. These few examples only touch the surface of the potential multiple issues created by attempting to provide this data. We would be pleased to spend more time with GASB staff to discuss this issue in greater detail.

Information Technology – Plans systems and processes will likely need to be adjusted to assist employers in capturing data to comply with the ED. This will require significant changes to those systems which will take additional time and increase costs.

Complexity – We believe the ED has added a great deal of complexity to take an inexact number and attempt to make it more precise. We do not believe the perceived precision is worth the additional complexity and cost.

October 13, 2011

Plan Assumptions and Factors – The ED states the employers **should** use the assumptions and factors of the plan. We believe it is critical that the employers be **required** to use the assumptions and factors of the plan. We believe this will allow for the most comparability between employers, reduce the work that would be necessary by the employers' auditors, and reduce the total cost of implementing the standard.

Allocation of Multiple Reporting Units – We are concerned with the difficulty of deriving a projected long-term contribution effort in order to calculate a proportionate share factor for each of our potentially hundreds or thousands of employers. This factor will need to be derived even for a single employer plan that has multiple discrete component units. We are most concerned with calculating a factor for an employer with a very small number of employees. We believe any allocation is arbitrary and inaccurate. We do not believe GASB's attempt to pursue accuracy by creating an undefined factor will provide more reliable information than a simpler approach such as an allocation based on current plan year contributions or payroll.

Allocation Variance Amortization of Multiple Reporting Units – Requiring the amortization of changes in the allocation proportion and variances in actual contributions compared to the proportionate share of the collective employer contributions will require actuaries to capture deferred inflow and outflow data at the individual employer level. We believe these changes should not be amortized, but recognized as expense each year.

Pension Expense – We believe that GASB should consider simplifying the calculation and deferral approaches of pension expense so that the number can easily be explained and related to the actual cost of doing business.

Other Concerns

Employer versus Plan Responsibilities – Clearly, each contributing employer will need the assistance of the plan in gathering the data necessary to comply with this ED. We question whether an employer could or should hire its own actuary to help satisfy the requirements of this ED. Again, for a multiple-employer plan, the logistics of working with potentially many employers' and auditors' actuaries will increase the costs of implementation and this raises the question of who should be responsible for payment of these additional costs. Since the ED does not enhance the plan or directly benefit the members, there are some serious concerns about whether the plan can legally incur these additional and significant costs to assist in the preparation of the employer's financial statements and if payment of these costs from trust fund moneys would raise IRS qualification issues.

Discount Rate Clarification – It is unclear in the ED whether the discount rate blending would need to be recalculated at each employer year-end or only at the plan year-end. In addition, it has become apparent to us that in some plans, member contributions

(especially with recent employer contributions swaps) exceed the annual service costs and we believe that these excess contributions should be used as an employer contribution for projection purposes.

Hybrid Plans – We are seeking further field testing and guidance on the handling of hybrid plans that include elements of both a defined contribution plan and a defined benefit plan.

Single Employer Definition – The definition of a single employer with discrete component units seems to conflict with the Implementation Guide Q&A 9.34.3.

Municipal Bond Rate Index – We are requesting further guidance on the source of the Municipal Bond Rate Index for the blended discount rate calculation as we are having difficulty determining an appropriate index.

Plan Administrator's Portion of NPL – For many multiple employer plans, the pension expense for the staff administering the plan is a direct administrative expense of the trust and any allocation of the NPL for those employees would reduce the net plan position used in the calculation of the NPL. Many of these plan administrators are also a participating employer in the pension system. The allocation of pension expense and net pension liability to the pension plan administrator as a participating employer, and by extension back to the pension trust, causes confusion in the financial statements. We are requesting further guidance on this issue in the final standard.

Entry Age Normal – Some plans within P2F2 are concerned that the entry age normal method is not appropriate for all types of plans. Thus, consideration of other methods should be made for plans that, due to various plan structure complications, are not easily valued utilizing the Entry Age Normal method.

Deferred Inflows and Outflows – We believe these should be netted together and we do not understand the value of keeping these items separate.

Amendment to GASB 27 – It was unclear in the ED what, if anything would be retained from the original statement.

Transition Date – We are very concerned that GASB appears to be rushing the implementation of this major decision. We believe it would be beneficial, practical, and prudent for GASB to allow sufficient time for a thorough analysis of the field test results as well as review of the comments received during its due process activities. Additionally, we believe an extended implementation timeframe is necessary so that the plans, employers, custodians, actuaries, and auditors can coordinate and work through the added complexities in order to smoothly transition to the new standards.

Employer Engagement – We are concerned that the employer community is not fully engaged in this dialogue. We believe they do not adequately understand the implications of this ED. Since GASB's key responsibilities is "...to guide and educate the public,

including issuers, auditors, and users of ... financial reports”, we respectfully suggest a longer comment period and that a re-exposure of the ED is necessary prior to the issuance of the final standard to ensure sufficient communication has been made available to all interested parties.

Termination Liabilities – Some employers in multiple-employer plans have the ability to terminate from the plan based on some specified methodology as stated in their plan document or statute. We are concerned that the allocation of the NPL may be misrepresented as a termination liability and mislead the reader of the financial statements.

Employer Disclosure – The volume of disclosure at the employer level seems excessive when the information is provided and available for reference within the plans’ separately issued annual report; therefore, we believe the employer’s disclosure requirements should be dramatically reduced.

Alternative and Simplifications to ED Approach

Employer Year-End – To reduce costs and to improve comparability of employers in the same plan, it is critical to change the proposed reporting requirements to allow employers to use the plan’s year-end information without adjustments. This alone will significantly reduce the plan administrative costs, actuarial costs, and audit costs related to this ED. Given that the TPL is long-term in nature and is an inexact calculation (\$350 billion to \$3 trillion range of estimates), we do not believe the perceived accuracy gained by revaluing assets and rolling forward liabilities within the 12-month period is worth the substantial additional costs.

Simplified Allocation Method to Employers – It would be possible to eliminate much of the cost and complexity of the allocation to employers by moving to a simplified allocation method performed as of the plan year-end. Ideally, a plan would provide, within its CAFR, all of the pension information at the collective level that an employer would need to determine the components of accounting and financial reporting at the employer level. The employer then could use the simplified allocation factor available to them to calculate their portion of the collective level information. That factor could be the pro-rata share of contributions for the plan year. This would allow the employer to easily calculate their portion at whatever financial reporting unit level they need for their own financial statements. An employer would then be able to easily allocate across multiple discrete component units and the primary government even if they were to send contributions in a consolidated manner to the pension plan.

Small Employers – Most multiple employer plans include a significant number of employers with very few employees and we believe the volume of disclosures is excessive. Also, we believe that the allocation is most apt to be unreliable and susceptible to large swings due to small changes in the staff of the employer. A retirement or termination of one long-term

highly paid employee could cause a significant swing in the liability for the employer. We believe strongly that small employers should be given relief from the burdensome rules of the ED and be allowed to use our recommended alternative disclosure approach.

Funding Approach – We continue to believe that a liability and expense calculation based on a funding approach is the most valuable information to the users of the financial statements. We believe the pension expense that is calculated based on the ED will be difficult to understand and will be misused.

Special Funding Situations – We believe all special funding situations should be accounted for and reported as conditional special funding situations.

We strongly urge the GASB to adopt an expanded disclosure approach for employers that require an allocation of the NPL, rather than the costly and complex accounting and reporting approach proposed by the ED. Additionally, we urge GASB to reconsider the effective dates proposed in the ED for implementation of the requirements and take the requisite time to review the field test data and reassess the approach taken in the ED before rushing to meet its proposed timelines. We suggest that GASB consider additional field testing and re-exposure of these critical accounting and financial reporting issues. Again, we appreciate the opportunity to comment on this project. Should you have any additional questions regarding these comments, please feel free to contact our organization by emailing me at LHuelskamp@mersofmich.com.

This response was prepared by a collective effort of the P2F2 membership. By our e-mail submission, the P2F2 Board of Directors substantially agrees with the views presented in this response. However, there are some areas where one or more P2F2 directors may have a slightly different perspective which will be shared with GASB in their systems' separate responses to the ED.

Sincerely,

Art Hewig, President & Luke Huelskamp, Past President