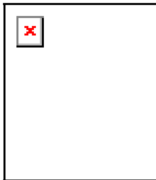

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July 30, 2009
Director of Research and Technical Activities
Project 34, Invitation to Comment - ***Pension Accounting and Financial Reporting***
Sent via email: Director@gasb.org

We are pleased to reply to the GASB's Invitation to Comment on possible revisions to Statements 25 & 27. Our responses to the questions presented in the Invitation to Comment are as follows:

1) To best achieve the financial reporting objectives of accountability and decision usefulness, including the assessment of interperiod equity, which of the following *processes related to pensions* do you believe governmental accounting and financial reporting should *provide information about*, and why?

   b) The process by which an employer finances its projected future cash outflows for defined pension benefits.

   Pensions are arguably the most complex financial transactions entered into by governments. The goal of accounting for pensions should be to take this complex information and provide users with disclosures that can be grasped. These disclosures must include adequate information about the current status of the plan, a report on the plan's stewardship during the reporting period and whether the plan will be able to pay future benefits, given the perpetual nature of governments. Experience has shown that the accounting presentation of the expenses and liabilities of public pension plans are best understood by users when those accounting costs and liabilities are in tandem with the funding of the plan.

   The financing of future cash outflows approach as reflected in the current GASB Statement 25 and 27 provides those characteristics. However, we feel that additional disclosures on the stewardship of the plan need to be included in the general purpose financial statements of the plan. The needed disclosures include the results of actions that have occurred during the reporting period by the plan's sponsor or responsible statutory body, and changes to the funding of the plan as a result of economic or demographic change.

2) What obligations of a sole or agent employer associated with pensions meet the definition of a liability in Concepts Statement No. 4, *Elements of Financial Statements*, and why?

   a) A measure of the cumulative difference between (1) amounts expensed, based on annual required contributions of the employer to the pension plan pursuant to a program of funding pension benefits developed within established parameters, and (2) the amounts the employer actually has contributed to the plan.

A pension plan is part of an employer's compensation package. The employer provides the funding for the plan in lieu of direct salary payments. The goal of the employer must be to make consistent contributions over time that will accumulate sufficient funds to pay promised benefits.

If plan benefits are improved, the employer is agreeing to provide an enhanced future benefit instead of current compensation. From the point that the benefit is enhanced and continuing for future periods, the employer must increase contributions to the plan to ensure the enhanced benefits will be paid at retirement. The accounting presentation should reflect whether the employer is doing this and, if not, the extent of the underfunding.

3) Which of the following expense recognition patterns is more consistent with the concept, in paragraph 27 of Concepts Statement 4, that *applicability to a reporting period or periods* for purposes of *expense recognition* in government-wide, proprietary fund, and fiduciary fund financial statements should be determined based on the notion of interperiod equity, and why?

   b) Deferred recognition (deferral and amortization) of some or all components of pension cost other than normal cost over a number of future years determined by an employer or by plan trustees within accounting parameters.

   The consistency that results from spreading recognition of the long-term unfunded actuarial benefit obligation over a comparable long-term period, without constant changes for short-term fluctuations, provides interperiod equity for the taxpayers. It reduces volatility that appears to require drastic decisions regarding over- or under-funding, thereby providing stability to members and employers.
   The amortization of pension costs (other than normal costs) over time is comparable to measuring the use of a capital asset by depreciation. It may not be "exact" but the process is understood by the user and provides a realistic and equitable assignment of those costs over time.

4) Should the projection of pension benefits include or exclude the following projected future changes? Why?

   a) Automatic cost-of-living adjustments (COLAs). **Automatic COLA adjustments must be included in the cost of projected pension benefits; excluding them dramatically distorts the future costs.**

   b) Projected future ad hoc COLAs, in circumstances in which ad hoc COLAs are substantively a part of the employment agreement, as demonstrated by an employer's pattern of practice**. Ad hoc COLAs that have been repetitive and on-going should be considered as part of the substantive plan and included in the cost of projected future benefits.**

   c) Projected future salary increases**. As we believe that the employer financing process should be used for recognizing liabilities and expenses, it is important that future salary increases and credits be recognized in the projection of benefits. This will allow the plan sponsor to accumulate sufficient assets to pay benefits based on the future salary and service credits when the employee retires.**

   d) Projected future service credits. **(see 4c)**

5) What should be the basis for determining the discount rate used for discounting projected pension benefits to their present value for accounting purposes? Why?

   a) The estimated long-term investment yield for the plan.

The long-term investment yield for the asset allocation chosen by the plan should be the discount rate. A public plan has the same goal as individuals saving for retirement – to accumulate adequate funds as efficiently as possible. A pooled plan allows investment professionals to invest in a mix of asset classes that reduce risk while maximizing returns. Public pension plan accounting should be oriented to this long-term view.

6) *If, after due process*, the accounting measurement approach adopted by the Board for pensions were to be one of those discussed in Chapter 4 that includes the amortization of some components of pension cost for purposes of recognition of an employer's pension expense:

   a) Which *actuarial cost method or methods* should be permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? Why?

      The reported actuarial cost method should be the one used to determine the pension plan's funding requirements. Prior experience has shown that it is important that there is consistency between funding and reporting. The plan trustees need to have the flexibility to make the funding policy choices based on individual plan structure, experience, employee composition, etc.; the accounting disclosure should not drive the decision.

   b) What should be the *maximum amortization period or periods* permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? **Thirty years.** Why?

      a. Thirty years is an acceptable approximation of an employee's career.

      b. **To allow more than thirty years would greatly increase funding costs.**

      c. **The time frame is consistent with the long-term nature of public pension plans.**

   c) Should *different maximum amortization periods* be set for different types of changes to the unfunded accrued benefit obligation?

      Generally, no. There may be circumstances where a specific substantial additional benefit or change in the actuarial assumptions should dictate separate amortization streams. Why or why not? **Requiring multiple amortization periods for different changes to the ABO provides little additional information to the user. Adding additional complex disclosures to a process that is difficult to understand can only thwart the user from grasping the information being presented.**

   d) If you answered yes to 6c, what should be the *maximum amortization period* for *benefit changes applied retroactively to past periods of service* that were not substantively a part of the employment agreements that established the compensation for services in those periods or were not previously included in the projection of pension benefits?

      For <u>substantive</u> changes in benefit accruals for past service, the amortization rate should be no more than the average remaining life of affected member. This is equitable for employers, future members and taxpayers in that such added benefit accruals should be fully funded by the time those employees leave the workforce and begin receiving the additional benefits.

e) Which *amortization method or methods* should be permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? Why?

Level percentage and pay and level dollar amortization methods should both be permitted; one may be more appropriate for a plan's unique circumstances.

Both open and closed amortization periods should be allowed for the same reasons. We believe that multiple closed amortization periods can be cumbersome and provide little added information to the financial disclosure, but believe they are appropriate in some conditions (see answer to 6d).

In addition, we believe that the consequences of amortization periods that result in negative amortization should be fully disclosed to users.

f) What method or methods of determining the *actuarial value of plan assets* should be permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense?

Phasing in investment gains and losses (smoothing) over multiple years should continue to be allowed. There should be limits in the length of smoothing, since long terms tend to approximate cost. Why? **Smoothing decreases volatility and provides for more consistent contribution rates. This is especially important for governmental entities and is consistent with long-term financing.**

7) Does the relationship between a cost-sharing employer and the cost-sharing multiple-employer plan in which it participates *differ enough in economic substance* from the relationship that a sole or agent employer has with the plan in which it participates to support different requirements with regard to liability and expense recognition? Which of the following views best represent your view, and why?

b) The relationship does differ in economic substance, and current measurement and recognition requirements are appropriate; however, additional disclosures by cost-sharing employers are needed.

<u>The Relationship Differs</u>
The future benefit obligation for employers participating in a cost-sharing plan has been pooled and there is not an amount that can be attributed to the individual employer. The employer has a contractual or statutory responsibility to pay contributions to the pooled plan to fund the benefits, but cannot contribute in excess or (or less than) the required amount, even if the assigned contributions are not enough to adequately fund future benefits.

The employers in a cost-sharing multiple PERS generally have very limited input to the plan and generally have no control over setting the contribution rates or whether those rates will adequately fund the system.

Adding a liability to the employer's financial statements that is not payable and cannot be reduced impacts the entity's normal operations and makes no sense to the employer's decision makers and stakeholders.

<u>Additional Disclosures Are Needed</u>
Currently, disclosure in the Statement of Funding Progress is only of a point in time. There is no way to assess the plan's stewardship of funding future benefits for its members over the reporting period. A statement of changes in the UAAL during

the fiscal year can disclose what occurred during the year and associated notes to that statement can provide a greater explanation.

The current schedule of actuarial gains and losses often provided by the actuary as part of the valuation process can form the basis for this statement, with the caveat that the "miscellaneous," unidentified" or" other" category cannot be a significant part of the explanation.

8) Which of the following should a pension plan report as its liability in regard to pension benefits, and why?

   a) A liability for benefits currently due and payable.

   A pooled multiple-employer PERS must disclose in the financial statements any benefit due and payable.

   We disagree that the plan should report the ABO as part of the basic financial statements. In the case of our pooled multiple employer system, it is not clear whether the ultimate liability for benefit payments lies with employers or the creator of the plan (the state).

9) Should a presentation of changes in the unfunded accrued benefit obligation be a required part of general purpose financial reporting? Why or why not?

   The plan's disclosure of the ABO is an integral part of the funding process and needs to be disclosed, so that Plan Net Assets can be understood in the context of the funding status.

   a) If yes, which financial report(s) should contain that presentation: the employer's, the plan's, or both? Why?

   The financial report should be part of the plan's financial report. The employer's report should reference the plan's report. Plan reports are almost universally available on the plan's website.

   b) If yes, should the presentation be a basic financial statement, a note to the basic financial statements, or required supplementary information? Why?

   The presentation should not be part of the basic financial statements, but rather as part of the required supplemental information. The ABO should not be a liability of the plan, but (as described above) be disclosed within the context of disclosing the funded status of the plan and the stewardship of the plan's funding during the year.

We appreciate the opportunity for input into GASB's Pension Accounting and Financial Reporting project. We thank you for your consideration of our views on these issues.

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