

Response to Proposed Employer and Plan Pension Reporting Requirements

I commend the GASB and its staff's efforts to improve pension reporting requirements. The proposed standards will significantly improve the financial reports of employers participating in defined benefit pension plans, cost-sharing plans, and single-employer plans. However, trend information is vital in evaluating the accountability of plan operations as emphasized in GASB Concepts Statement 1. Therefore, the exclusion of the requirement to report trend information as Required Supplementary Information in agent-multiple employer plans will result in less accountability and transparency in agent-multiple employer plan financial statements.

Comments on Accounting and Financial Reporting for Pensions an Amendment of GASB Statement No. 27

I agree with the requirement to report the Net Pension Liability (NPL) in the financial statements. The NPL results from service already performed. Failure to report the liability distorts the financial position of the employer and is misleading to users of the employer financial report. Also, I agree with using the fair value of investments instead of the actuarial value of assets in calculating the NPL since the actuarial value of assets may be materially different than the fair value of assets which would result in a material misstatement of the actual liability.

I agree with all aspects of reporting the changes in the total pension expense except for the differences between projected and actual earnings on plan investments. I understand the Board's concern over the volatility of investments and the impact this volatility can have on the pension expense from year to year. However, I believe investment earnings (losses) are an expense in the period incurred. Additionally, the Plan is required to recognize investment gains and losses in the period earned. Allowing the employer to defer and amortize investment gains (losses) mismatches the reporting requirements of the employer and Plan.

The new Required Supplementary Information will greatly improve the accountability and transparency of employer financial reports. The 10-year schedule of changes in the net pension liability provides financial statement users with information that is needed in order to evaluate the reasons for changes in the employer NPL over time. In order to improve accountability, plan mandated modifications and employer management decisions that impact the NPL should be segregated in the schedule of changes in the net pension liability. For example, employers participating in agent-multiple employer plans often elect whether or not to accept modifications to benefits offered by the plan. Examples of benefit modifications that required employer election which have occurred in the Employees' Retirement System of Alabama (ERS) include:

- Cost of living adjustments
- Changing the service requirement from 30 years to 25 years for employers participating before passage of the Act.
- Electing to participate in the Deferred Retirement Option Plan (DROP).

However, other modifications to the Plan are mandated. An example is a benefit modification that requires adding one year of service for each five years of service in calculating the benefits of firefighters, law enforcement and correctional officers

Each of the above benefit modifications resulted in significant increases in the NPL. Readers of employer and plan financial statements should be able to evaluate the impact of plan (including legislative) mandates versus employer decisions on the NPL. The Schedule of Changes in NPL provides the best trend information to perform this evaluation.

I agree with the Special Funding Situation reporting requirements for nonemployer on-behalf payments. However, I am concerned that nonemployer contributing entities will change the method of providing funds in order to avoid the special funding reporting requirements. In the past, the state of Alabama was required to provide employer contributions directly to the Teachers' Retirement System (TRS – a cost-sharing plan) on behalf of employers participating in the TRS. However, years ago Alabama changed the law so that the pension contributions are provided directly to the employers with the other grant funds. Alabama is required to provide approximately 60% of the local school systems total operating costs directly to the employer. In substance, Alabama is responsible for a significant portion of the TRS NPL. However, due to the manner in which the funds are provided, Alabama will have no reporting requirements related to the TRS NPL. Readers of Alabama's CAFR will not be informed of the state's significant commitment to the local school boards. The Board should consider requiring a commitment note when an entity is required to provide a significant portion of another entity's funding requirements.

Comments on Financial Reporting for Pension Plans an amendment of GASB Statement No. 25

Trend information is crucial in assessing the accountability of a plan. The schedule of changes in net pension liability provides greater accountability than the schedule of changes in funding progress. In order to enhance accountability, the schedule of changes in net pension liability should segregate changes in the NPL resulting from employer decisions and plan mandates.

The schedule of changes in net pension liability also should be provided for agent-multiple employer plans. I understand the Board's concerns about the costs of rolling actuarial information forward to the reporting date exceeding the benefits of providing the information. However, a properly prepared schedule of changes in net pension liability provides readers of plan financial statements with the best information available for assessing the efficiency and effectiveness of plan operations.

Rolling forward the schedule of changes in net pension liability is probably the most costly trend data for agent-multiple employer plans to provide. The Board should require all trend data with the exception of the schedule of changes in net pension liability to be reported as of the report date. The schedule of changes in net pension liability should be reported as of a date not more than one year from the reporting date. Actuarial valuations are performed annually for most large pension funds. The costs of providing the data would be minimal and undoubtedly would be better than providing no trend data at all.

I agree with the Board's modification of the concentration of investment risk disclosure from the current requirement of disclosing concentrations of investment credit risk to concentrations of investments as originally required in GASB 25. However, I believe that the function nearly all pension plan administrators have the most discretion over is the investing function. This is also the function that, in most instances, has the greatest impact on a NPL. All other functions of the organization are usually set by law such as benefits and contribution requirements. Therefore, investment disclosures should be expanded so that financial statement users can assess investment risks resulting from plan administrators' investment decisions. I would modify/add the following investment disclosure requirements:

- Expand the disclosure to include significant investments in an entity, industry, country, commodity or investment fund. FASB recently implemented this requirement. This would provide a better understanding of the investment risks related to investment decisions.

- Change the concentration requirement to material concentrations instead of stating a specific rate so that auditor judgment determines the proper disclosure. The new FASB requirement is based on materiality instead of a set percentage. Surely if a pension plan has a \$20 billion portfolio and the plan has \$400 million invested in

one entity, this would be considered material and would be of interest to the users of financial statements. If a stated rate was used, the rate should be reduced to 2% (\$400 million in one entity for a \$20 billion portfolio).

-Expand the concentration disclosures to include concentration of investment gains or losses. The required disclosure amount could be based on the average of the beginning and end of the year total investments. Without this requirement, material gains or losses related to a particular entity are not disclosed and accountability is impaired. For example:

-Assume that a pension fund has a \$20 billion portfolio at the beginning of the year and an \$18 billion portfolio at the end of the year. The pension fund has a \$1.8 billion investment in Company X at the beginning of the year. During the year, the pension fund loses \$1 billion of its investment in Company X. At the end of the year, there would be no required concentration disclosures related to Company X because it would not meet the 5% concentration requirement. Also, there is no required disclosure for this material loss. Extensive gains in a particular entity are just as relevant since this could be an indication that the pension plan may be overly reliant on one company which could lead to significant losses in the future. This disclosure would provide relevant information concerning whether the pension fund administrators' are meeting their fiduciary responsibility or are assuming too much risk. I would disclose any gains or losses on a particular entity based on whether the gain or loss is material in relation to the average of the beginning and end of year plan investments.

The discount rate of many pension funds is based on the fund's historical long-term rate of return. However, past performance is not always an accurate indicator of future performance. Most economists predict slow economic growth for the foreseeable future. An inaccurate discount rate is the greatest risk for misstatement of the NPL. I agree with the Board's decision to provide data based on a discount rate of +/- 1% of the discount rate used in calculating the NPL. However, due to the subjectivity in determining the discount and the inherent risk of misstating the NPL, rates of return provided in the RSI should include trends in long-term rates of return.

I agree with the Board's decision to include rates of return in the Required Supplementary section. The rate of return schedules provide data that can be used in evaluating the fund's investment performance and the accuracy of the discount rate. In addition to annual rates of return, long-term rates of return, such as 10, 15, and 20 year returns, should be provided so that financial statement readers can assess the accuracy of the discount rate based on the trend in the fund's long-term rates of return.

Thank you for the opportunity to respond to the proposed standards.

Sincerely,

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Retired Financial Reporting Manager

Retirement Systems of Alabama