Letter of Comment No. 220
File Reference: 34-E
Date Received: 10/14/11

Foster&Foster INC.

Actuarial Consultants for Retirement Programs

October 10, 2010

Mr. David Bean
Director of Research and Technical Activities
Project No. 34
Governmental Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bean:

We thank the GASB for giving us this opportunity to provide our comments on the Exposure Draft relating to Accounting and Financial Reporting for Pensions. As consulting actuaries with a large public employer client base we are feel it is appropriate to comment on an important aspect of the proposed Statement that deals with actuarial gains and losses.

The proposed Statement is intended to "improve the decision-usefulness of information in employer reports and enhance its value for assessing accountability and **interperiod equity."**

In requiring that actuarial gains and losses attributed to inactives be immediately recognized, the proposed statement accomplishes just the opposite. This requirement is needlessly complex, costly to implement, confusing and distorts interperiod and entity to entity comparisons.

The Board has stated that it has evaluated concerns about the expense volatility that immediate recognition will produce but was not persuaded by these concerns. It's rationale for allowing this volatility to enter into employers' financial statements is that the cost of an employee's pension should be recognized during the periods that the employee provides service to the employer. That guiding principal is a red herring in this discussion since immediate recognition fails to accomplish that objective. By definition, retirees have no remaining service over which to attribute costs. The real issue is how to account for their demographic gains and losses in a reasonable and systematic method.

In considering how to deal with mortality gains and losses the question isn't whether the retirees will die. That is quite certain. The question is how does the actuarial treatment of the timing of their deaths affect the usefulness of the information in employer reports and interperiod and entity to entity comparisons?

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Consider the following scenario. A group of 10 retirees has a present value of benefits of $2.5 million. The plan in which these retirees participate is 70% funded. The plan currently amortizes its unfunded liability over 30 years. Actuarial gains and losses are amortized over 10 years.

To illustrate how this group of inactives' demographic gains and losses would affect pension expense we performed a Monte Carlo simulation using standard mortality table assumptions and a random number generator to simulate deaths among the model population and recorded the resulting actuarial gains and losses. We ran this simulation 10 times and show 3 of the recorded outcomes. Each of these outcomes is equally likely to occur.

Deaths occur randomly and sporadically over the first 30 years, occurring in years 10, 19, 20, 21, 25 and 27 in Scenario 1, Years 5, 20, 21 and 25 in Scenario 2, and years 2, 5, 6, 12, 16 and 25 in Scenario 3.

Let's take a look at how the expense would vary using either a 10 year amortization of gains and losses or immediate recognition under each of these scenarios. Exhibit 1 presents the comparison for Scenario 1. As expected, the 10 year amortization approach is much smoother. Under the immediate recognition approach large actuarial gains deliver significant reductions in expense whenever a death occurs. In intervening years the expense is higher than under the 10 year amortization approach.

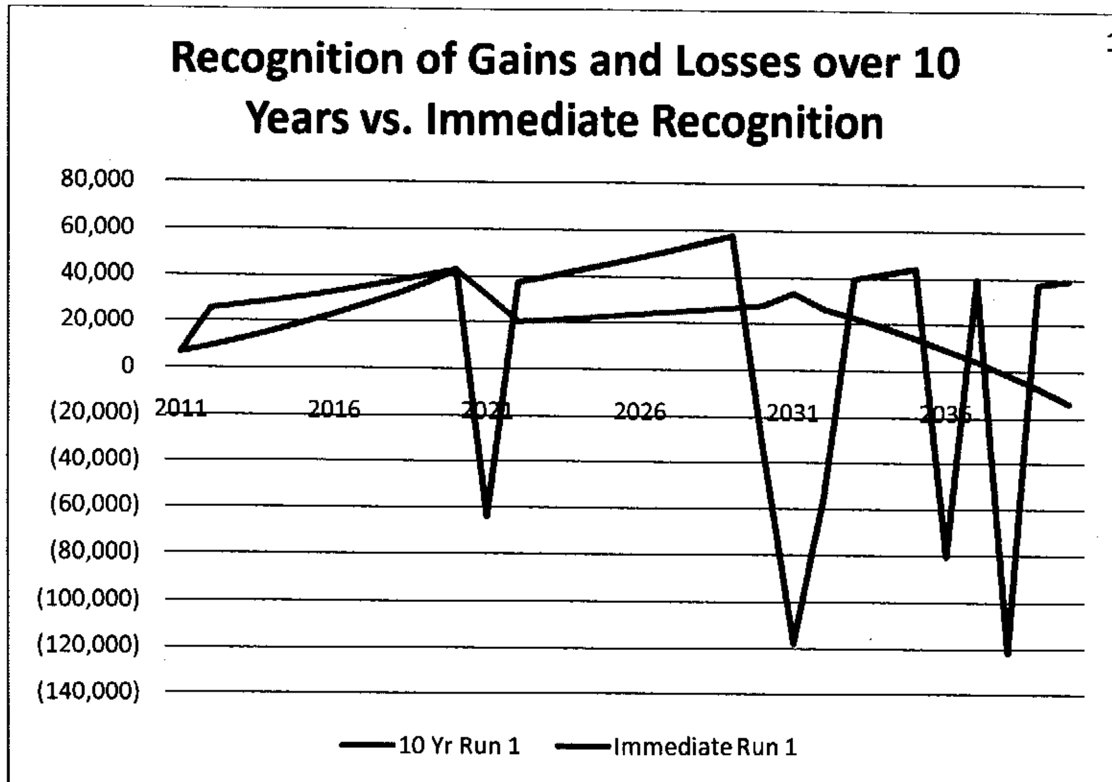

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Exhibit 2 paints a similar picture for Scenario 2, with a dramatic gain due to multiple deaths in year 21.

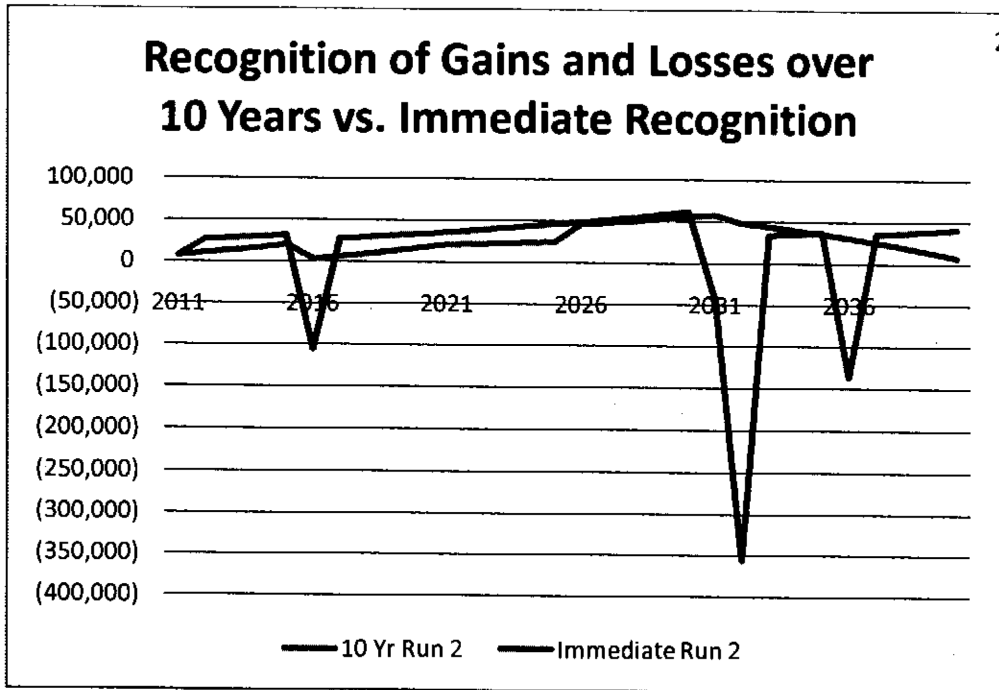


Exhibit 3 shows even more volatility for Scenario 3.

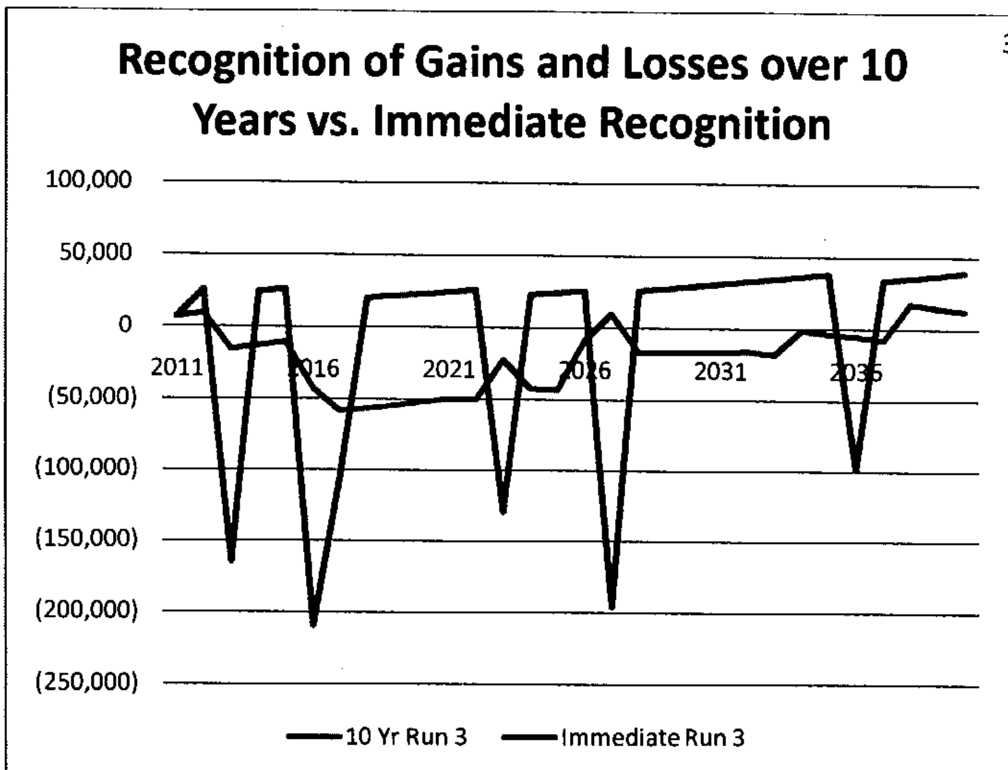
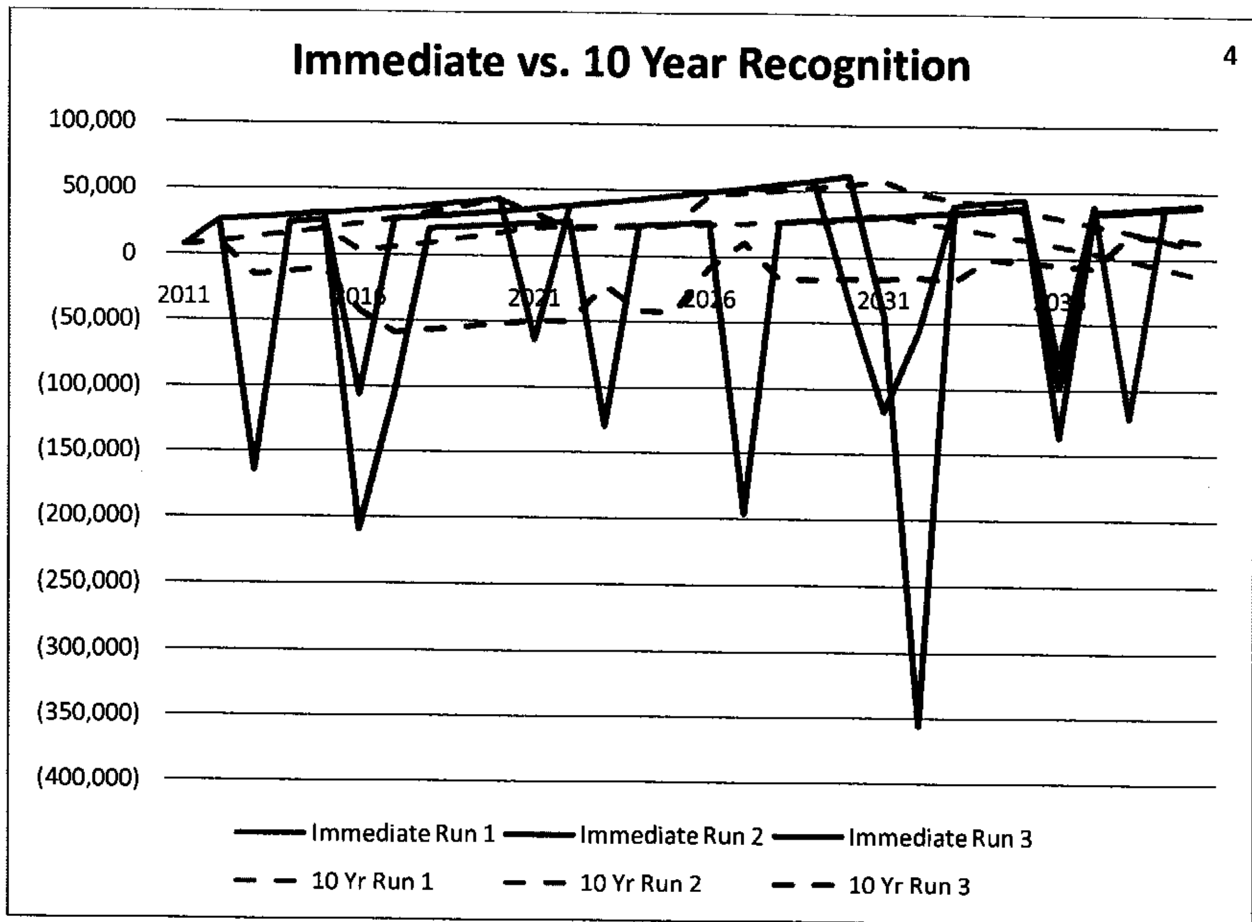


Exhibit 4 is a summary chart of the three Scenarios.



In each of these Scenarios the residual liability is approximately 20% of the original liability. If we view the Scenarios as representing the pension expense patterns of separate similar cities we can consider whether the extreme volatility of expense resulting from the death of a given retiree is an improvement in financial accounting or an enhancement to interperiod equity. Will users of financial statements dig deeply into a city's reports to see if the reduction in expense can be explained by the death of a retiree? Will they understand when the expense reduction is temporary and goes away the following year? We think not.

As clearly demonstrated, the proposed Statement introduces needless volatility and complexity. Because of the additional noise attributed to short term fluctuations, when the change in liability is the same over the given time horizon, results are more difficult to understand, and so are less decision-useful. Interperiod and entity to entity comparisons will be less meaningful, not more.

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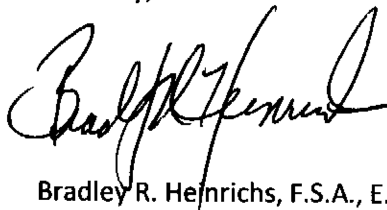
Since actuaries do not currently isolate gains and losses for inactives there will be an added expense for complying with this provision.

Again, we thank the GASB for this opportunity to provide comments. If we can provide any additional information or answer any questions regarding this letter please contact us.

Sincerely,



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