Letter of Comment No. 254
File Reference: 34-E
Date Received: 10/14/11

VICE PRESIDENT FOR FINANCE AND BUSINESS SERVICES

Roudebush Hall Room 218
Oxford OH 45056-3653
513-529-4226

October 12, 2011

Mr David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Project No. 34-E

Dear Mr. Bean:

On behalf of the Inter-University Council of Ohio (IUC), we submit the following comments regarding the GASB's Exposure Draft (ED), *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27.* The IUC represents Ohio's 14 public universities. Its comments on the ED were developed with input from experienced business officers from our member institutions.

The GASB is to be commended for its efforts to improve the visibility of the unfunded actuarial liabilities associated with our public pension plans. Today, many of our constituents are unaware of the magnitude of these amounts and would be surprised to learn that the total pension liabilities associated with our cost-sharing, multiple-employer pension plans (e.g., the Ohio Public Employees Retirement System (OPERS) and the State Teachers Retirement System of Ohio (STRS)) are not reported on the balance sheets of Ohio's statewide retirement systems. These large unfunded amounts, which are in the tens of billions of dollars for our state's largest public pension plans, are simply too large to ignore. However, the proposed accounting and reporting standards – particularly the requirement for cost-sharing employers to recognize net pension liabilities on the face of their financial statements – raise significant concerns and uncertainties for preparers, auditors and users of our financial reports. The following sections of this letter outline our concerns and propose an alternative approach for reporting these unfunded amounts.

Our first and most fundamental concern is that there is no legal support for GASB's assertion that our member institutions are liable for any underfunding in the cost-sharing defined benefit pension plans. Under Ohio law, if a faculty or staff member chooses to participate in a cost-sharing defined benefit pension plan (such as the OPERS or STRS defined benefit plan), then the public university employer is required to make *contributions,* at a legally prescribed rate, to such

plan. Ohio law does not require that the public universities pay the benefits (or fund any unfunded liabilities) under the cost-sharing defined benefit pension plans; instead, the statewide retirement systems (e.g., OPERS and STRS) are responsible for paying those benefits. Any future changes in the terms of the pension plans to address underfunding would require the approval of the Ohio General Assembly and are outside the control of public employers in Ohio. Furthermore, changes to address underfunding may not be limited to increases in public employer contributions only. Underfunding could be addressed in multiple ways by the Ohio General Assembly, including increasing age and/or years of service required to retire and increasing required employee and employer contribution amounts. Ultimately, if there was a plan termination, default, or some other unlikely event, the General Assembly would need to determine the final dispensation of any unfunded liability.

GASB Concepts Statement 4, paragraph 17, defines the financial statement element *liabilities* as "present obligations to sacrifice resources that the government has little or no discretion to avoid." Cost-sharing employers in Ohio, however, have discretion to avoid the unfunded obligations of OPERS and STRS because they are not liable for these amounts under Ohio law. The law drives GASB standards in various areas (enabling legislation, accounting/reporting on restrictions, pollution mediation obligations, etc.) – why ignore the law when it comes to pensions?

Second, the proposed balance sheet recognition of the net pension liability raises serious potential auditability issues for cost-sharing employers. How do the auditors get comfortable with the calculation of the total pension obligation and the allocation to the individual employer? If there is a lag between the pension plan's yearend date and the employer's yearend date, how does the auditor get comfortable with the rollforward of the balances? What happens if the public accounting firm that is auditing an employer is unable to rely on the pension plan auditor's work? In the State of Ohio, if a public institution receives a qualified audit opinion, it may be subject to expanded oversight and other sanctions under our existing Senate Bill 6 fiscal watch rules.

Third, we seriously question the decision-usefulness of including this liability on a public institution's balance sheet. It does not present a realistic picture of our member institutions' ability to pay their bills and continue providing educational services. It may be helpful to consider the example of one of our member institutions, The Ohio State University (OSU).

OSU prepared an estimate of the impact of the proposed accounting standard based on information on "Valuation Assets" and "Actuarial Accrued Liabilities" that the retirement systems disclosed for Fiscal Years 2006 through 2010 in their Schedules of Funding Progress. OSU's share of the net pension liability is estimated, based on OSU's covered payroll as a percentage of the retirement systems' total covered payroll. For simplicity, it is assumed that a

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beginning net pension liability, with no deferred outflows or inflows, is recognized as of June 30, 2006. All changes in the net pension liability have been recorded in current year pension expense, with the exception of the differences between projected and actual investment returns, which are amortized to pension expense over a five-year period. Dollar amounts are presented in millions.

The Ohio State University	**2006**	**2007**	**2008**	**2009**	**2010**
Summary of Financial Statement Effects DR(CR):					
Deferred Outflows (Inflows)	-	(349)	1,116	1,040	496
Net Pension Liability	(886)	(621)	(1,829)	(2,642)	(2,881)
Expendable Net Assets	886	970	713	1,602	2,386
Pension Expense		84	(257)	890	783

As you can see, the potential impact is tremendous. At June 30, 2010, for example, the recognition of the estimated $2.88 billion net pension liability and related $496 million of deferred outflows would reduce the university's expendable net assets from $1.75 billion to a *negative* $633 million. Also note the volatility in current period pension expense, which ranges from a $257 million negative expense in FY2008 to an $890 million positive expense in the following year. Recognizing an extremely large and volatile new liability that will not be paid out in the normal course of business would obscure, rather than clarify, OSU's financial position and the results of OSU's operations. This liability would have to be explained and excluded from almost any type of analysis of OSU's financial statements.

Fourth, the balance sheet recognition of net pension liabilities by cost-sharing employers would create significant issues with our regulators, academic accreditation agencies and other important users of our financial reports. Under Ohio's Senate Bill 6 rules mentioned earlier, a composite score – consisting of a combination of the viability ratio, primary reserve ratio and net income ratio – is calculated for each public institution. If the proposed accounting changes were in place, OSU's composite score, for example, would drop from a relatively strong 4.2 (5 is the highest possible score) to 0.8, a level that would trigger "fiscal watch" sanctions under current administrative rules. The U.S. Department of Education uses very similar ratio-based scores in determining the continued eligibility of institutions to participate in federal student aid programs. The potential inability to receive these funds would be devastating to public institutions. Our academic accreditation agency, the Higher Learning Commission, calculates a Composite Financial Index (CFI) and subjects institutions to increased scrutiny if the scores fall below certain levels. Similarly situated public and private institutions would calculate vastly different CFI scores if the proposed accounting changes were to go into effect. Continued accreditation could be at risk. Finally, based on our discussions with representatives of the debt-rating agencies, we do not see evidence to support the GASB's assertions that the rating agencies have already incorporated estimated liabilities of this magnitude in their financial analyses of our institutions. With each of these constituencies, an institution would need to explain why the

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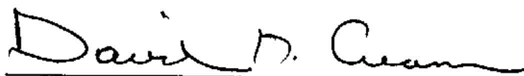
allocated net pension liability is unlike any other liability on its balance sheet and essentially discount its significance for evaluation and decision-making.

In summary, we believe that any allocation of unfunded pension liabilities to cost-sharing employers would be arbitrary and misleading. The retirement systems have the authority to request contribution and benefit changes for legislative consideration and action. We recommend that the net pension liability be reflected on the financial statements of the retirement system where the assets for future pension benefits are also reported. In addition, we recommend that the GASB require the disclosure of unfunded pension liabilities in cost-sharing employers' footnotes. Presenting the unfunded pension liabilities in this manner will make them more visible to financial statement users without triggering major auditability issues or reducing the decision-usefulness of cost-sharing employers' financial statements. Also, to more fully anticipate the potential concerns of financial statement preparers and users, we recommend that the GASB consider the issues raised in response to the Financial Accounting Standards Board's September 2010 proposed Accounting Standards Update, *Compensation—Retirement Benefits—Multiemployer Plans (Subtopic 715-80): Disclosure about an Employer's Participation in a Multiemployer Plan.* This proposal – which was limited to footnote disclosures only – was strongly opposed by a majority of the respondents. The data quality, timeliness and auditability concerns raised by respondents to the FASB proposal are equally relevant to GASB's ED.

In closing, we wish to express our appreciation for the opportunity to comment. We look forward to answering any questions the Board may have about our response. Please feel free to direct your questions to Tom Ewing, OSU's associate controller, at 614-688-3113 or ewing.6@osu.edu.

Sincerely,



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On behalf of the following IUC member institutions:

Bowling Green State University
Central State University
Cleveland State University
Kent State University
Miami University
The Northeast Ohio Medical University
The Ohio State University
Ohio University
Shawnee State University
University of Akron
University of Cincinnati
University of Toledo
Wright State University
Youngstown State University