Letter of Comment No. 267
File Reference: 34-E
Date Received: 10/18/11

Public Employees Retirement Association of Minnesota
60 Empire Drive, Suite 200
Saint Paul, Minnesota 55103-2088
Member Information Services: 651-296-7460 or 1-800-652-9026
Employer Response Lines: 651-296-3636 or 1-888-892-73
PERA Fax Number: 651-297-2547 ◆ PERA Website: www.mnpera.org

October 10, 2011

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

Dear Mr. Bean:

Thank you for the opportunity to provide comments on the pension Exposure Drafts issued by GASB. We appreciate your willingness to receive and consider comments from pension plans like ours. This letter is in response to Project 34-E, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*. We administer cost sharing and agent multi-employer defined benefit plans along with a defined contribution plan, serving over 400,000 benefit recipients and active/inactive members.

We commend the Board for reviewing pension accounting standards. We believe the proposed standards, however, will be less useful than existing standards, will be very costly and time consuming to administer, and will provide misleading and confusing information to users of financial statements.

Liability

Although we agree that a pension obligation is created as a result of an employment exchange, we do not believe the pension obligation meets the definition of a liability worthy of being added to the face of the financials, and is better left as a footnote disclosure. GASB Statement No. 3 states that financial statement elements need to be measurable with sufficient reliability. GASB Statement No. 4 states that liabilities are present obligations to sacrifice resources that the government has "little or no discretion to avoid." We believe that pension obligations fail both tests.

The assumption that the pension liability cannot be avoided by the employer has proven to be false in Minnesota. The Minnesota legislature, in conjunction with PERA and the other statewide pension plans, address unfunded liabilities quite often. In 2010, for example, legislation was passed that lowered future COLAs for existing benefit recipients, lowered interest rates paid to members receiving refunds, increased active member contribution rates, and adjusted actuarial assumptions. As a result of those changes, the pension liability was decreased by almost $3 billion, none of which was paid by the employer.

Letter of Comment No. 267
File Reference: 34-E
Date Received: 10/18/11

Pension liabilities are "paid" from several sources, including employers, members, investment earnings and the State of Minnesota. They are reviewed every 4 years as actual experience differs from investment and actuarial assumptions. Because the pension plan and state legislature address unfunded liabilities on a regular basis, we do not believe that a pension liability, which will not be paid for 40 years, can be measured today with any reliability whatsoever, nor will it be the responsibility of the employer alone, thus should not be moved to the face of the financials.

Should the Board continue to believe the pension obligation meets the test of a liability that should be moved to the face of the financials, we recommend that the liability be put on the financials of the plan, not of individual employers, in cost sharing plans. Since we do not believe the pension obligation can be measured reliably at the collective level, we certainly do not believe the pension obligation can be allocated with any reliability between our thousands of employers.

Participants in Cost-Sharing Plans

Approximately 6,000 different reporting units contribute to PERA from approximately 2100 different employers. Many of the reporting units are joint ventures between two or more employers, and several are component units. In many cases we do not know whether the reporting unit has its own set of financials or is reported under another entity. We have several concerns related to the current ED approach of reporting a pension liability and the new definition of pension expense on the face of the employer's financials.

- **Administrative Costs** -- We believe the cost of the annual actuarial work required to allocate the NPL and pension expense to our employers will triple our actuarial costs and require significant staff time necessary to prepare information for our actuary and communicate results to employers. We also believe the costs of auditing employer financials would increase for all of our employers, costing millions of dollars each year.
- **Timing** – Since the State Board of Investment invests our assets, we do not receive fair market values until 4 months after the close of our fiscal year. We receive actuarial valuations 5 months after the close of our fiscal year, and receive our audit certification letter 6 months after the close of our fiscal year. We will not be able to provide our employers the information they need to complete their own financials in a timely manner unless we provide them with year-old, out of date information.
- **Plan Disclosures** – A considerable amount of time and money would be involved in calculating individual components of the pension expense every year for each employer, and would need to be done by the plan's actuary. Hundreds of our employers are small townships with one active part-time member, so may be overwhelmed by the amount of disclosures required by the ED. It would be much simpler and cost effective to keep plan disclosures at the plan level, referred to by individual employers in their financials.
- **Insolvency** – Based on preliminary calculations, the pension liability would likely put many of our employers in an insolvent position based on the balance sheet bottom line, despite the fact that most employers will never be required to pay the NPL.

Letter of Comment No. 267
File Reference: 34-E
Date Received: 10/18/11

- **Employer Year-End Reporting** – We do not believe we can accurately roll forward asset values to match employer fiscal year ends in a timely fashion, given that 15% of our portfolio is invested in alternative assets that are valued three to six months in arrears, and only on an annual basis. Real Estate valuations, accruals, administrative expense allocations and investment expense allocations are also calculated on an annual basis only. It would be costly to run those processes at every employer fiscal year end.
- **Allocation Process** – Allocating the NPL based on each employer's "expected long-term relative contribution effort" is an expensive and overly complex allocation method that can only be calculated by the plan's actuary.
- **Volatility** – Calculating and booking the NPL (and indirectly the pension expense) using the market value of assets will create a high level of volatility to the financial statements of each employer, adding confusion and concern to the citizens of each local government.

Discount Rate

We support the GASB's decision to use the long-term expected rate of return on investments as the discount rate, and understand GASB's decision to use a different rate when resources are not available in the plan to be invested long-term. If the underlying theory is that employers will be required to issue debt to pay the pension obligations, however, the index used should be a high-quality taxable municipal bond index, rather than a non-taxable index.

Average Remaining Service Life

As presented in the ED, changes in the NPL due to changes in the liability for active members would be recognized "over a weighted average of the remaining service periods of employees." Using a "weighted" average adds complexity and cost to the process without adding value. We believe any change in the pension liability due to active members (plan provisions, assumption changes, demographic gains and losses, etc.) should be recognized over the remaining service periods of employees using a simple average rather than a weighted average.

Disconnecting Accounting Measures from Funding Measures

We believe the accounting measures identified in the ED will distract from the more important existing accounting/funding measures used by policy makers. Existing accounting measures tell the reader whether or not an employer is on track to systematically fund the future cost of pensions by a specific date (as spelled out in Minnesota statutes). The measures are easy to understand, and trends can easily be identified. The new accounting measures as proposed in the ED replace that important information with a very volatile NPL which will likely be overstated and will be expensive to compute and allocate to employers. Especially in poor investment years, policy makers are likely to overreact when they see large increases in the NPL along with a corresponding deterioration in the bottom line on employer balance sheets. Trends will be difficult to identify, and showing two sets of numbers will be confusing for all of the users of our financials.

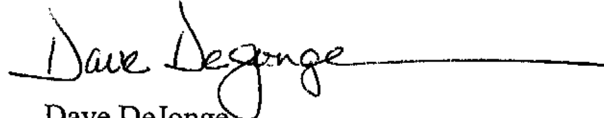
We believe the linking of accounting and funding measures has helped us "weather the storm" the past few years because they are easy to understand by policy makers and are smoothed to

Letter of Comment No. 267
File Reference: 34-E
Date Received: 10/18/11

prevent panic decision making. If that link is not maintained, however, we hope the GASB Board will consider the recommendations outlined above. We are especially concerned about the timing problems and the additional cost that will be incurred by PERA and our employers should the Board mandate that the NPL be moved to the face of our employer's financial statements, calculated as of the employer's year end.

Thank you again for providing this opportunity to provide our comments.

Sincerely,



Mary Most Vanek
Executive Director

Dave DeJonge
Assistant Executive Director

Public Employees Retirement Association of Minnesota