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September 30, 2013

Director of Research and Technical Activities
Project No. 3-20E
407 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Exposure Draft on Measurement of Elements of Financial Statements

Dear Director, Staff and Board Members:

Thank you for the opportunity to share some brief thoughts about the GASB's Concepts Statement (CS) Exposure Draft (ED) relating to Measurement of Elements of Financial Statements. And thank you for all the hard work you all do for the public.

I am writing about the relationship of this CS ED to GASB Statement No. 68 and the Other Post-Employment Benefits project you are currently deliberating. I am writing primarily to agree and commend the Board on its definition of Settlement Amount, as set forth particularly in paragraph 39(b) of this CS ED.

Background

As this CS project was being deliberated over the past several years, so was the Pension standard (and more recently the OPEB project). They have been running parallel. I was following the pension project (and now OPEB) most closely; but I was also watching this measurement project out of the corners of my eyes. Not being an accountant, I was continually running to stay up with you all.

But I saw the connection. While both projects were being deliberately concurrently, I did not know which one would be completed first. I was pleased with the direction the Board was going with the Pension measurement principles it had tentatively adopted; and pleased, of course, that they found a home in the final version now known as Statement No. 68 (and 67).

I knew the measurement of the Pension liability was going to need to fit nicely into whatever the Board would finalize concerning the CS on measurement. As it became clear that the Pension standard would be adopted before the CS, I was concerned that the final CS might not contain adequate language to capture the measurement principles already adopted in the Pension standard.

My desire for consistency was driven by the notion that if the Pension measurement principles were good enough for the Board to adopt for a Pension standard, at roughly the same time as deliberating a measurement CS, then they were good enough to be captured within the final CS on measurement. I think you did exactly that -- in paragraph 39(b) of this ED.

But this concept is not limited to an application solely to Pensions and OPEBs. It feels like it might authorize a similarly appropriate application to other types of liabilities.

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Pension and OPEB Settlement

When discussing the settlement and valuation of Pension and OPEB obligations with my financial economics friends, I have often described Pension and OPEB liabilities as being “***settled a little at a time over a long period of time***”. That phrase reflects the terms of the arrangement -- the ongoing settlement agreement embodied in the exchange transaction between the employer and employee. Paragraph 39(b) states:

“A settlement amount can be either (a) the amount that the counterparty would accept to settle the liability or would pay to satisfy a receivable at the date of the measurement or (b) the amount that will be realized from an asset or will be needed to liquidate the liability in due course according to the terms of the arrangement between the government and the counterparty.” [My underline emphasis]

This subparagraph authorizes the measurement principles in the Pension standard which capture the current value of the long-term cost to taxpayers and the basis for the cost of services. Without the concept described in paragraph 39(b), the Board might face a challenge in proceeding with the OPEB standard.

For Statements 67 and 68, the Board specifically rejected a market or fair value model, in favor of a model with these qualities:

- *Counterparty.* The Pension standard measures the government’s obligation due to the counterparty. That is very different from the market or fair value model promoted by many who call for an exit price marked-to-model for a transaction with a third party, leaving intact the basic obligation to the counterparty at the same default rating (a poor model for marking a fair value I might add). The Pension standard reflects a settlement with the plan members of its obligation to them. And so should the OPEB standard.
- *In due course according to the terms of the agreement.* The Pension standard measures the obligation embodied in the career-long exchange transaction between the employer and employee. It reflects the amount needed to liquidate the liability in due course according to the terms of the arrangement. If the net pension liability, as measured per the Pension standard, were added to the plan’s fiduciary net position, there would be sufficient assets to liquidate the Pension liability (attributed to date) in due course according to the terms of the arrangement (under the given set of assumptions). And so should the OPEB standard.

Preserving the nature of the obligation’s original terms and conditions in its due course measurement seems an important attribute to capture whenever appropriate. Governmental sector Pension and OPEB liabilities are seldom ever settled in a single sum and seldom ever discharged in a transaction with a third party. They usually have a similar life expectancy as the government itself.

Because the benefit structure is in place, operating perpetually (usually) to compensate a perpetual workforce, the measurement of the attendant obligation feels almost like a “value-in-use”. Paragraph 39(b) authorizes that, the last sentence of paragraph 36 emphasizes that, and the actuarial profession has a long-standing and formalized process for measuring the obligation on that basis.

Without this language in paragraph 39(b), this Board and future Boards would be challenged to justify the Pension measurement it has just recently adopted and similarly challenged to shoe-horn the tentative decisions made in the OPEB project.

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- *Remeasurement.* The Pension standard describes a remeasurement of the Pension liability on every measurement date. However, on each new measurement date it is no longer the same liability. That makes the remeasurement of most Pension liabilities very different from the remeasurement of many other liabilities and similar to a few others.
- *Expected cost.* The Pension standard for funded pensions calls for the current value of the long-term “expected” cost to taxpayers, i.e., the amount “*expected* to be needed” to liquidate the liability (attributed to date) in due course according to the terms of the arrangement. It is a best estimate of the cost to taxpayers. It is not a “fair value” or a “market value” or a “market-consistent” value. Those do not reflect the long-term cost to taxpayers. But an “expected value” does. And so should funded OPEBs.

Conclusion

After this lengthy commentary on what you did (although my shortest comment letter ever), I agree and commend the Board for including among the measurement attributes a variation on “settlement amount” as the amount that is “*needed to liquidate the liability in due course according to the terms of the arrangement between the government and the counterparty*”.

Suggestion 1

You might consider additional language concerning choices among various numbers for a given approach/attribute. Values that involve fixed quotes at a point in time (bid/ask) might need some concepts elucidated. Values that are contingent on future factors or variables may have generally reliable probability distributions associated; and language concerning the concepts of how “expected value” versus guaranteed value or ranges such as more-likely-than-not or equally-likely might affect the concept of fair representation could be considered.

It has always seemed to this non-accountant that “expected values” better convey the notion of fair representation and best estimates than do methods that tilt toward conservatism or worse-case-scenarios, or that we should err on the high side for liabilities and the low side for assets. Is this a measurement concept?

Suggestion 2

I recognize that, once the measurement CS is adopted, the Board cannot go back and clarify how the Pension standards’ measurement principles were consistent with the newly adopted measurement CS.

However, as a matter for clarity, the Basis of Conclusions for the OPEB standard will likely refer to the Board’s reliance on the Pension standards. To take that a step further, the OPEB ED and Standard’s Basis for Conclusion would be the perfect place for an explanation of how its measurement attributes fit into the concepts set forth in paragraph 39(b) of this CS.

Again, thank you for this opportunity and for all your hard work.

Sincerely,



James J. Rizzo, ASA, MAAA