



## GOVERNMENT FINANCE OFFICERS ASSOCIATION OF TEXAS

September 23, 2011

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

RE: Project No. 34-E & Project No. 34-P

The Financial Reporting and Regulatory Response Committee of the Government Finance Officers Association of Texas (GFOAT) would like to take this opportunity to respond to GASB's Exposure Drafts on "Financial Reporting for Pension Plans" and "Accounting and Financial Reporting for Pensions." **We would also request the opportunity to testify telephonically at the October 20<sup>th</sup> public hearing in Chicago.** The GFOAT is an affiliate of the national Government Finance Officers Association and the Texas Municipal League. The GFOAT's membership represents all levels of state and local government in Texas.

The GFOAT appreciates the time that GASB has continued to spend on the topic of pension accounting, and the opportunity to respond to GASB's Exposure Drafts (ED) on this issue. The Committee remains concerned about the direction that the GASB has taken, and reiterates the position taken in its letter dated September 7, 2010 to GASB's Preliminary Views document. However, the Committee recognizes that the probability of GASB making a major change in direction at this point of the process is remote, and therefore will focus this response on specific parts of the ED that the Committee feels could be changed to be more useful or practical.

### ***CHOICE IN ACTUARIAL METHODS***

The ED mandates use of the Entry Age Normal actuarial cost methodology for projecting benefit payments. The Committee notes that Entry Age Normal is a preferred method for *funding* pension benefits, due to its level contribution approach. However, this approach does not match how employees earn their benefit during their career. It overstates the benefits and liability for an employee throughout their careers, until eventually arriving at the correct amount at retirement. The Projected Unit Credit (PUC) actuarial cost methodology is a better indicator of *benefits earned* to date, and has the potential for many pension plans to demonstrate a truer measure of inter-period equity. The GASB should either allow pension

plans to select from Entry Age Normal or Projected Unit Credit, depending on which actuarial methodology best matches the benefit structure provided by the plan or like the FASB simply mandate PUC for financial reporting purposes. The GASB has clearly chosen to separate accounting from funding and therefore should allow the method that best reflects the true benefits earned to date.

### ***ADDITIONAL FUNDING DISCLOSURES***

During the years they have been in effect, GASB Statements 25 and 27 created a national standard for measuring and reporting whether pension plans were adequately funding their obligations through requiring disclosures of the Actuarial Required Contribution (ARC). The amount of the ARC being funded is a primary indicator of a pension plan's health and discontinuing its emphasis eliminates a key statistic used by credit market and other analysts as well as other users of government financial statements. The new ED requires both footnote disclosure of funding policy and RSI disclosing Actuarial Calculated Contributions (ACC) information but this approach is vastly inferior to the previous approach for the following reasons:

- a) Actuarial Standards of Practice are very high level principles based standards that provide individual actuaries far more discretion in professional judgment than GASB Statements 25 and 27.
- b) There no longer would be a nationwide minimum standard for funding or nationwide standard definitions of key actuarial terms. Each entity working with their actuary will be allowed to develop their own unique ACC definition.
- c) Financial statement users who are not actuaries and may not even be accountants will be forced to make their own determination on a plan-by-plan or employer-by-employer approach whether the method chosen is adequate to fund the plan over time.
- d) Auditors have very limited association with RSI and will no longer be required to provide the same level of assurance as to whether the employer or the plan are following an appropriate funding approach and making the contributions as reported.

For these reasons, the Committee recommends that the following notes disclosures be added to enhance usefulness of the information being presented:

- The government should specifically state in the footnotes whether assumptions used for accounting and funding purposes are different or the same. For example, if different mortality tables are used for funding vs. reporting or if the version of entry age for funding is not identical to that used for reporting, these facts should be disclosed.
- The government should also include information about the covered payroll growth assumptions used in calculating the pension liability as it will be a much more critical assumption in amortization for funding purposes given the amortization approach chosen for reporting.
- Finally, one year of ACC vs. actual contributions should be in the footnotes to extend audit coverage to this important calculation.

The Committee also believes that governments should be required to provide a discussion of pensions in their Management's Discussion & Analysis (MDA) section. Such discussion should include reasons for changes in the liability from year to year, as well as what strategies the governments use for funding or addressing the liability.

### ***TREATMENT IN STATEMENT OF NET POSITION***

If a plan is underfunded, guidance suggests that the funding deficiency would reduce Unrestricted Net Assets on the Statement of Net Position, and for many governments result in a negative Unrestricted Net Assets/Position. If a plan is overfunded, guidance suggests that the excess would be reported as a separate component of Restricted Net Assets on the Statement of Net Position.

The Committee recommends an alternative approach based on GASB's treatment of capital assets. The Committee believes that GASB should define a new component of Net Position, Net Position of Post-Employment Liabilities, which would report the net effect of all assets, liabilities, deferred inflows, and deferred outflows that relate to pensions.

Pensions and other post employment benefits are unique material parts of a government's operations and with numerous components being mandated to be displayed separately, this approach would allow users to quickly assess the impact of these benefits on the Net Position of the government. GASB's presumed direction on OPEB accounting provides additional support for this approach.

### ***VOLUME OF EMPLOYER DISCLOSURES***

The Committee notes that there is a substantial increase in the amount of information required as part of the employer notes and RSI. While much of this information will be valuable for understanding the pension benefits and related costs for each government, the Committee believes that this volume of information combined with the fact that many single employer governments have multiple pension plans will overwhelm both the reader and the remainder of the notes section for many governments.

The basic financial statements of the employer are intended to be *general purpose* in nature but disclosures required in the ED go far beyond that level of detail. To mitigate this, the Committee recommends excluding disclosures that are already included in the same level of detail in web site accessible pension plan financial statements. An appropriate note reference should point users specifically interested in pensions to the original source of the information, the PERS, without taking away from other important disclosures. In these situations, the governments can include a listing of additional information that is available in the pension plan financial statements including the link to those financial statements.

The problem with the ED approach, is that updating of the valuation to the employer's balance sheet date mean that very little of the information will tie or articulate between the employer and the plan that it originated from (see also discussion below). We know of no

easy solution given the direction of the ED's but also believe that even the greatly expanded employer disclosures fall short of providing all information necessary for an in depth understanding of the plan but far exceed the level of information the average reader would need in order to understand the overall financial position of the government.

### ***EFFECTIVE DATE***

The Committee is greatly concerned about the proposed effective dates. GASB anticipates that a final Standard will be issued in 2012, with the employers required to report for periods ending June 30, 2013 (first tier plans) and June 30, 2014 (second tier plans). Pension plans are required to implement the new guidance for the same periods which due to differences in fiscal years could mean the plan is implementing after the employer.

For example, the City of Dallas Employee Retirement Fund is a first tier plan with a December 31<sup>st</sup> year end. The City of Dallas has a September 30<sup>th</sup> year end. In order for the City of Dallas to comply and implement this proposed standard by September 30, 2013, its plan will have to early implement and conduct its valuation on the new pension plan standards as of December 31, 2012. This provides virtually no time for Dallas ERF and its actuaries to plan for, implement and communicate impacts of the new standard. Delay in the issuance of financial statements for first tier employers is almost inevitable.

The 840 city employer members of the Texas Municipal Retirement System (TMRS) are similarly affected. TMRS, has a December 31<sup>st</sup> year end, and has member cities with eleven different year ends. Its actuary would be required to perform two valuations, one for funding (PUC) and one for reporting (Entry Age Normal) and 840 updates with extensive reporting packages attached. The GASB mandated valuation will require 840 closed plan cash flow projections to determine each plans discount rate and 840 different amortization periods based on each member city's remaining service lives. These calculations would also have to be repeated each year for each plan. They would be facing a significant amount of work, communication and education to both the Board of Trustees and to the member cities. Yet in spite of this daunting workload, the proposed effective dates would force TMRS to early implement in order to allow their member cities to comply with the employer effective date.

Public sector pension actuaries are an extremely specialized profession with relatively few firms nationwide. These firms serve clients all over the country, many with the same year ends. The work and costs associated with the new standards would be significant and imposing unreasonably short implementation dates would only increase both costs and the likelihood of errors, problems and delays.

### ***ARTICULATION BETWEEN PLAN NET POSITION AND THE NPL***

GASB Statements 25 and 27 did not attempt to have any relationship between the plan financial statements and the actuarial calculated unfunded actuarial accrued liability. However, the ED's define the NPL as the TPL minus the PNP.

This creates an interesting situation when the plan financial statements are required to be reported in the employer's fiduciary fund column. In the case of a December 31<sup>st</sup> pension plan and a September 30<sup>th</sup> employer, the employer would report PNP in the fiduciary column as of December 31<sup>st</sup> but would have used an updated September 30<sup>th</sup> PNP for calculation of the NPL. The committee believes that it would be less confusing for everyone for the standard not to attempt to create relationships that will not be there in the case of plans and employers with different year ends.

This same principal holds true for multi-employer agency plans. A statewide PERS is typically going to have a separate operating fund for administrative expenses and will not allocate miscellaneous receivables or payable out to their hundreds of member governments. NPL should simply be the TPL minus the Market Value of Assets updated to the employer's year end. The miscellaneous receivables and payables included in the PNP are as of a specific date in time and would clearly be immaterial.

### ***CONCLUSION***

The Committee continues to have many significant reservations and concerns regarding the proposed pension standards. These reservations are well documented in our response letter to the PV (PV response letter 17 maintained on your website) and we will not repeat them in detail here. We believe, however, that the changes we have recommended above would be meaningful improvements to the standards as proposed.

Before it issues final pension standards, the Board should be convinced that the benefits of the new requirements outweigh the associated costs. In the committee's view, even if our proposed changes are incorporated, we do not believe that test has been met. In our view the major costs and benefits of the GASB pension proposals are as follows:

#### **Costs**

- 1) Losing the clear link and articulation between the employer and the plan financial statements.
- 2) Deemphasizing the independent and important role of the PERS in fulfilling the pension promise.
- 3) Loss of a nationwide standard for funding including standard definitions of actuarial terms for funding purposes.
- 4) Creation of much more complicated financial statements including both large deferred inflows/outflows and voluminous footnotes for users to understand.
- 5) Forcing users to either understand or simply choose between two set of books in the form of two valuations, two sets of trend information etc.
- 6) Increasing the cost of actuarial valuations by requiring PERS that wish to actuarially fund its plan to have two valuations and possibly an update.
- 7) Removing from both the plan and employer financials and notes the very decision making information elected officials need most-actuarial funding and contributions.
- 8) Removing that actuarial funding and contribution information from direct audit coverage.

- 9) Creation of an extremely volatile and difficult to understand twelve element expense number that will have no relationship to an actuarially adequate contribution.

**Benefits**

- 1) Providing a clear, balance sheet date liability in the employer's financial statements.
- 2) Advancing a more conceptually pure theory of inter-period equity by divorcing the accounting from the reality of how government operates and funds pensions.
- 3) Increasing auditor attention on the actuarial liability (assuming a balance sheet liability will garner more auditor attention than a liability disclosed in the notes).

Respectfully:



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