Letter of Comment No. 94
File Reference: 34-E
Date Received: 10/5/11

SACRS
State Association of County Retirement Systems
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September 15, 2011

Director of Research and Technical Activities, Project No. 34-P & E
Governmental Accounting Standards Board (GASB)
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
director@gasb.org

Dear Sirs and Madams:

Re: Financial Reporting for Pension Plans (amendment of GASB Statement No. 25)

This letter is in response to the GASB Exposure Draft on new accounting and financial statements (Project Number 34 P) as seen from the perspective of public sector pension systems.

The State Association of County Retirement Systems, (SACRS) is a 57-year-old association consisting of the retirement systems in twenty California counties whose systems were created under the California County Employees Retirement Law. The SACRS member systems assets total approximately $80 billion and provide benefits to 400,000 county employees and retirees. These systems have been providing benefits to their members for over 65 years.

There are significant differences between pensions in corporate America and public sector America. The issues of profitability, mergers, acquisitions, and bankruptcies are foreign concepts in the world of public pensions. Public pensions do not focus on the short-term performance as found in the corporate world. Between legislation and court rulings, the public pension benefits are well established, vested, protected and will enjoy longevity well into the future.

Opening Comments
On September 10, 2010, this association responded to a number of issues raised in the GASB Preliminary Views on Pension Accounting and Financial Reporting by Employers. SACRS also presented testimony at the public hearing In San Francisco on October 14, 2010. Some of our concerns raised in our comments on the . Preliminary Views continue forward into the Exposure Drafts.

As stated in your Proposed Exposure Draft, "the primary goal of the Governmental Accounting Standards Board (GASB) is to develop high-quality standards of accounting and financial reporting for state and local governments. High-quality standards lead to information in financial reports that improves transparency, assists in assessing accountability, and is useful for making important decisions."

We continue to be quite concerned that in an attempt to create more disclosure, "transparency" and "useful" information; separating the methodology of pension expense from pension funding will lead to confusion and more difficulties in presenting and reconciling useful information.

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The proposed changes will require employers to recognize an unfunded obligation as a balance sheet liability in their financial statements based on market value. We continue to believe showing the on-going funding status is a more meaningful measurement to the various stakeholders of the public pension.

The GASB revisions will require employers to recognize a new set of measurements on pension expense in their financial statements that may have little relationship to actuarially determined contributions. They will exclude information on the actuarial funded status of the benefits. This will result in a third document to provide an explanation of the differences between the two approaches.

Recognition of pension liability on the government employer's financial statements
Placing the pension and eventually, the OPEB, on the employer's financial statement is a matter for the employer to address to GASB. We can foresee that by having the pension expense separate from pension funding will lead to confusion on the part of many readers. Will "full disclosure" cause public employers to seek to be better financially then they are now under the current methodologies?

Measuring Pension Liability
We believe that the Net Pension Liability methodology proposed by GASB is too volatile. The calculation of the NPL may show wide ranges from year to year, especially if actuarial adjustments for inactive members must be immediately recognized. The proposal requires that deferred inflows and outflows be recognized. Our suggestion is to combine the deferred recognition with the NPL to modify or smooth the calculations.

As a result of this GASB requirement, we wonder if the actuary or the trustees of the pension fund may be distracted from their fiduciary responsibilities, as they are now aware that any changes would immediately impact the financial statements of the employer.

It is not possible to fund the pension based on these accounting numbers. We think that GASB also sees that problem. The Exposure Draft does state that these proposals would only be required for accounting and financial reporting purposes. But the difference between the pension funding methodology and the GASB Total Pension Liability would have to be explained.

How useful is this approach and who is the audience? Will this new approach to presenting information on the financial conditions of the public employer really change the bond rating of the public employer? We think not. Rating agencies may gain little from these revised statements over what they are already obtaining. All this information is currently available and published. True, it may entail some additional research, but that is already being done by the rating agencies.

For the other stakeholders, unless the public pension or the public agency also produces a third document explaining the differences between the funding and accounting disclosures there will be confusion. One of the guidelines that GASB set out with this approach is to create transparency and useful information. We believe that real "useful" information will be found in the third document we will have to prepare.

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Measuring Pension Expense

The proposed methodology will require that the costs of the pension be calculated in a manner that would be quite different from the contribution requirements of the plan. The GASB approach attempts to disclose all pension costs to the period in which they are earned. This is clearly a private sector, corporate model being overlaid on the public pension. Although a corporation model tends to function from quarter to quarter - a governmental entity functions on at least an annual basis. Revenues for public entities are derived and are sustained in a far different manner than the corporate environment. The public sector does not equate specific costs to specific services as found in the corporate world.

It appears that GASB is trying to develop a methodology to capture any and all pension expense on the employer's financial statements as quickly as possible. Changes that involve inactive members would be reported immediately. Changes to active members would be recognized over the weighted average of the active employees. We note that there is a significant difference between weighted average and average employment period. An average employment period would be 10 to 15 years; whereas, a weighted average would reduce the time frame to 5 to 7 years.

GASB is pursuing a model where public services must be in a direct and timely relationship to costs for services. That number could never be funded without intergenerational transfer until a pension reaches full funding. We think that if GASB wishes to change methodology to pursue inter-period equity in the public sector, it should develop a reasonable phase-in methodology for implementation.

Governments in Cost-Sharing Plans

For pensions with multi-employers plans, there will be considerable difficulties in implementation. Plan disclosures related to plan asset position as well as actuarial findings may result in the plan having to prepare comprehensive documents twice a year to meet the needs of employers who have financial statements that run on a fiscal or a calendar year basis.

The issue of who will pay the costs for the additional and detail calculations will be a significant issue between the employer and the pension plan.

We are concerned that GASB's methodology will lead to "best interest" and self-selection on the part of the individual employers. Employers with adverse cost issues will want to remain pooled. While other employers may determine that for cost purposes, they would move to independent status. Sacrificing investment returns from a pooled strategy in order to change a cost presentation should not be encouraged.

Special Funding Situations

The distinction between employer and non-employer leads into issues in the relationship between the federal government and local government. A significant amount of revenue is channeled to local government for the implementation of federal programs. Historically, the federal government has allocated funds to entities based on funding not expense. GASB should consider seeking comments on this aspect of the proposed changes with federal officials.

Many public employers have established enterprise funds for certain programs, yet the employees are considered to be members of the pension. Would an enterprise fund be considered differently than part of the existing governmental structure?

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Conclusions and Comments

Based on the Preliminary and now the Exposure Draft, we are of the opinion that the methodology set forth in Project 34 is irreversible. It is our understanding that GASB plans to release the final standards in the spring of 2012. Less than six months from now. Plans with $1 billion or more in assets will have to begin with the first fiscal year ending after June 15, 2010. For most plans that means June 30, 2010. We are concerned that literally hundreds of public pensions and employers will have to begin reporting under the new methodology without any of us knowing the full range of consequences to the changes. Clearly there are a large number of complexities, including data and coordination issues. Therefore, we feel that the proposed transition dates should be adjusted to allow more time for implementation.

We also foresee that there will be a need for a "bridging document" to explain the differences in pension expense and funding methodologies. What that document will contain will not be known until we have had the opportunity to implement the new statements. Again, this is another reason to allow an extended test period to determine this issue.

We would suggest that GASB seriously conduct field tests with a wide variety of public employers and their pensions systems (beyond those currently being tested) and evaluate the results before implementation. The proposed GASB changes are major and there is really no room for unforeseen consequences with the proposed timelines.

Thank you for the opportunity to comment on the Exposure Drafts under Project 34-P, please feel free to contact me directly at sirbpalmer@aol.com or 916-441-1850.

Sincerely,

Robert Palmer

Robert R. Palmer
SACRS Executive Director