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Director of Research and Technical Activities Project No. E-34 Governmental Accounting Standards Board 401 Merritt 7, PO Box 5116 Norwalk, CT 06856-5116

RE: Comments on Project No. 34-E and 34-P

Please accept my comments on the Pension Accounting and Financial Reporting exposure draft. I used the plain language questions in 34-E as it allowed me to express my feelings on 34-P without going to greater length. Hopefully you can use them as comments related to Project 34-P also. I ask you to take into account that I am not an expert in the area of Pension accounting as some comments may be affected by my lack of knowledge of current practices. While I work for the City of Helena, MT and have been auditing or preparing comprehensive annual financial reports for over 20 years, I am not commenting officially on behalf of the City of Helena.

The City is part of a cost-sharing multi-employer pension plan managed by the State of Montana. My comments are therefore based on how this proposed standard will affect me as a preparer and my thoughts on the user's ability to use and understand the information being proposed.

Thank you for your consideration and please contact me if you need any clarification on my comments.

Sincerely,

Glenn Jorgenson, CPA

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# City of Helena, MT Comments to Project 34-E

# Questions for Users about Recognizing the Net Pension Liability

- 1. Do you agree or disagree with GASB's proposal that governments recognize the net pension liability in their financial statements? Why do you agree or disagree?
  - **a.** For single-employer and agent multiple-employer pension plans I somewhat agree. My reasoning that the costs are known and a single entity is generally responsible for decision making regarding benefits and funding of them. Their decisions should be reflected in the financial statements. However, my main concern is that actuarial valuations are too subjective to be relied on for decision making and operating income/loss will become less meaningful.
  - **b.** For cost-sharing multiple-employer plans I do not agree. I added my comments here and for questions 7 and 8 as my comments in the remaining sections are mostly based on cost-sharing multiple-employer plans. I disagree because:
    - i. Most local governments in this type of plan do not participate in decision making as do single-employer and agent multiple-employer plans.
    - ii. This type of plan is like purchasing insurance or participating in Social Security (SS) and Medicare. Why isn't GASB requiring us to record the Social Security liability also (not that I am recommending that)? There is no difference whatsoever between SS and cost-sharing multiple-employer plans.
    - iii. It doesn't appear to be meet cost-benefit analysis. The exorbitant amount of actuarial costs and staff time preparing the information for the approximately 530 participants of our State's plans and local staff time would not justify the benefit since the liability is already reported properly at the plan level. Easy to understand footnotes or RSI information could be provided to show a reasonable estimate of a participants share and would be just as relevant without the work GASB is proposing.
    - iv. My experience with OPEB actuarial valuations and studies conducted statewide show actuarial assumptions and liabilities are a wild guesstimate at best. Furthermore, assumptions appear to vary considerably with no relevant reasons for the differences. Just changing a couple of variables a minor amount can result in a material change that distorts results of operations.
- 2. How would recognizing the net pension liability in the financial statements affect any or all of the following;
  - a. The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?
    - i. For cost-sharing multiple-employer participants I feel it would harm all these factors in the proposed method of accounting for the expenses in the operating section of the financial statements, especially focusing on proprietary funds. Reasons are:
      - Readers of financial statements should be able to assess the results of operations. Recording regular, material changes in long-term pension liabilities will distort operating information and affect comparability between years.
      - 2. Actuarial valuations are at best a wild guesstimate based on currently known facts, and assumptions of the future, that can change day-to-day. The current economic environment demonstrates large changes can occur in investment income and valuation, funding policies, benefit changes, etc. resulting in unrealized gains or losses that really have no bearing on the results of current operations of participants and may be better deferred and/or expensed separate from operating information.

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3. Bond coverage requirements are being unfairly changed by GASB standards related to OPEB and now pension changes will compound the problem. For example, Montana only has an implicit rate subsidy. Annual OPEB expenses and large changes in valuations are causing distortions in operating income/expenses and making it difficult to even budget for coverage requirements. Historically we have set rates to ensure we comply with bond coverage requirements and have a viable capital replacement program in our proprietary funds. We are now being forced to consider raising rates to cover OPEB expenses that really don't exist. Adding more pension expenses will only cause us to increase rates to meet coverage requirements with no adequate reason to justify it to our citizens. For instance, if we have an amount due to the State because they raise the contribution rate, that would justify a rate increase. With no amount currently owed we will have to raise rates to meet coverage, but it will only result in more cash on hand. While it's great to have the additional cash to spend on capital, it should be based on our perceived needs, not forced on the citizens by changes in GASB standards.

# b. Your ability to assess a government's accountability?

i. I believe it would be diminished in all cases. Large changes occur regularly in pension liabilities due to all types of factors outside the control of participants. Incorporating constant assumptions of what might occur in the future into operating information will render it useless when assessing accountability.

# c. Your ability to assess interperiod equity?

i. I believe it would be diminished in all cases.

### Questions for Users about Measuring the Total Pension Liability

- 3. Do you agree or disagree with the GASB's proposal for how the total pension liability should be measured? Why do you agree or disagree?
  - a. If a liability is to be recorded I agree with the proposed methods other than using a different rate if the plan is not completely funded. I know there is a great push by many parties to incorporate lower rates. However, my research indicates plans have earned the rates they use on average over long periods. Until someone can prove otherwise a wild guestimate should not be greatly increased. Furthermore, I believe the municipal bond rate has had a lot of variability in it also the last few years which will not help mitigate material distortions in operating income.
  - b. This comment may be influenced by my knowledge of current rate assumptions. It appears there is insufficient lack of guidance proposed to indicate the blending of the rates. For instance, if a plan is just slightly underfunded does it get the same blended rate as one that is highly underfunded? If not, who makes that determination of proper blending? It appears to be something easily manipulated that will further erode the credibility of the wild estimates being made.

# 4. How would those proposals affect any or all of the following:

- a. The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?
  - i. The usefulness of the information is diminished. I think the summary of proposals makes my comments under question 2 more relevant. If we are to assume future salary increases, adhoc Colas, etc we should also then factor in recessions along with decreases in the related benefits and

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increases in employee participation rates when liabilities are projected to be large. These are a fact of life as is currently happening all over the world. My point is that when a liability gets unmanageable politicians will attempt to lower them and rarely by just increasing participation rates which comes directly from taxpayers. Incorporating highly subjective estimates does not help decision making, the work I do, or the decisions we make.

# b. Your ability to assess a government's accountability.

i. Again I feel it is diminished as these liabilities are subjective and unreliable with the tendency to vary too much to provide credible information.

### c. Your ability to assess interperiod equity?

i. Again I feel it is diminished as these liabilities are subjective and unreliable with the tendency to vary too much to provide credible information.

## **Questions for Users about Measuring Pension Expense**

- 5. Do you agree or disagree with GASB's proposals regarding when the factors that affect pension expense should be incorporated into the expense calculation and why?
  - a. I disagree with most proposals. I do feel it is warranted to set specific time frames for deferrals for consistency and comparability if required. However, I feel this section is indicative of one of GASB's greatest weaknesses in standard setting. Maybe my inexperience with pension actuarial information may cloud my response, but it appears that expensing some parts and deferring others makes it less comprehensible by any user and less usable. I further find it ironic GASB wants to expense projected earnings immediately (4a), but defer actual earnings (4c). Furthermore, separating retiree information vs. active employees just for two parts just adds to the confusion and understandability of the information. I suggest you defer and expense to smooth all parts or expense them all at once. This should help lower the amount of confusion and footnotes required.

### 6. How would those proposals affect any or all of the following:

- a. The usefulness of the information to the analyses you perform, the work you do, or the decisions you make.
  - i. I believe GASB is continuing its trend of making the financial statements totally incomprehensible to anyone but very sophisticated users. Furthermore, as stated earlier I feel GASB is making it impossible to determine the results of operations by incorporating large quesstimates. For instance, a local school district received one OPEB valuation at around \$19 million. After hiring a new actuarial firm and changing a few assumptions it went to \$2 million. Another illustration is an article by V. Gopalakrishnan and Timothy F. Sugrue, George Mason University, in the Journal of Financial and Strategic Decisions, Volume 8, No 1, found easily on the internet that states that a 1% change in the discount rate can change the pension liability by 20%. Furthermore they went on to describe corporations are choosing factors that meet their financial reporting needs more than based on proper pension reporting, especially when debt requirements are involved. Obviously pension liabilities are not an exact science and incorporating unreliable estimates provides users with unreliable information making it less useful and comparable.

### b. Your ability to assess a government's accountability?

i. I believe it would be diminished due to incorporating too many variables

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no one will understand except the actuary that creates them.

- c. Your ability to assess interperiod equity?
  - i. I believe interperiod equity will be less useful.

# **Questions for Users about Governments in Cost-Sharing Plans**

- 7. Do you agree or disagree with the GASB's proposals that governments in costsharing multiple-employer plans report a liability equal to their long-term proportionate share of the collective net pension liability? Why do you agree or disagree?
  - **a.** As stated earlier, for cost-sharing multiple-employer plans I strongly disagree. I disagree because:
    - i. Most local governments in this type of plan do not participate in decision making as do single-employer and agent multiple-employer plans.
    - ii. This type of plan is like purchasing insurance or participating in Social Security (SS) and Medicare. Why isn't GASB requiring us to record the Social Security liability also (not that I am recommending that)? There is no difference whatsoever between SS and cost-sharing multiple-employer plans.
    - **iii.** It doesn't appear to be meet cost-benefit analysis. The exorbitant amount of actuarial costs and staff time preparing the information for the approximately 530 participants of our State's plans and local staff time would not justify the benefit since the liability is already reported properly at the plan level. Easy to understand footnotes or RSI information could be provided to show a reasonable estimate of a participants share and would be just as relevant without the work GASB is proposing.
    - iv. My experience with OPEB actuarial valuations and studies conducted statewide show actuarial assumptions and liabilities are a wild guesstimate at best. Furthermore, assumptions appear to vary considerably with no relevant reasons for the differences. Just changing a couple of variables a minor amount can result in a material change that distorts results of operations.
- 8. How would recognition of a proportionate net pension liability affect any or all of the following:
  - a. The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?
    - i. As previously stated I feel it would further diminish the usefulness of the financial statements particularly in the area of assessing results of operations. Large changes outside of the local governments control will cause large swings in operational results of individual funds. Furthermore, the citizens will be impacted by rate setting requirements related to outstanding debt that were not present when the debt was issued.

### b. Your ability to assess a government's accountability?

i. I believe this is diminished greatly. The study by V. Gopalakrishnan and Timothy F. Sugrue previously referenced concluded that assumptions such as the discount rate and salary progression rate were chosen by corporations to meet there financial statement needs rather than to show what they believed was the true liability. Small assumption changes in these rates result in large changes in the pension liability. I ask how "paper" gains and losses based on assumption changes and other changes out of the control of local governments can improve accountability? Recording the liability in the State's funds may be

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relevant since they are the ones with the decision making ability, but not the local government participants.

# c. Your ability to assess interperiod equity?

i. I also believe that assessing interperiod equity will be diminished. Including a liability that is highly speculative and can be manipulated easily by changing a few variables does not help readers understand interperiod equity. History has shown that instead of the local governments funding the liability, it will be more likely lowered using a combination of higher employer and employee premiums and decreased benefits. Therefore we would be recording a liability when most likely we will not be responsible for funding the majority of it.

#### Questions for Users about Notes and RSI

- 9. Do you agree or disagree with the GASB's proposals regarding note disclosures and RSI? Why do you agree or disagree?
  - a. While I agree some disclosure is appropriate I believe the amount proposed is highly excessive. GASB is really missing the impacts it is trying to achieve on timeliness and relevance. Users can refer to the pension plans statements if it needs this level of detail. The amount of work and expense our state will have incur to provide this information to over 530 local participating governments will not be cost beneficial. I feel GASB has done nothing but pass large unfunded mandates one after another starting with GASB 34. Recently GASB had the audacity to write in GAAFR Review articles it is exploring ways to have financial statements prepared in a timelier manner for decision making purposes. GASB needs to realize that local governments do not have unlimited budgets to meet all the reporting requirements GASB staff theorizes about.

# 10. How would these disclosures and RSI affect any or all of the following:

- a. The usefulness of the information to the analysis you perform, the work you do, or the decisions you make?
  - i. Again, some disclosure is responsible reporting. The extent GASB is proposing is excessive. For instance, showing schedules in RSI for both the pension plan as a whole and the portion for the participant of a multi-employer cost-sharing plan would appear irrelevant. The other participant's share of the liability should be in their statements and can also be found in the plans statements as a whole. This is compounded when you consider our City alone is involved in four different retirement systems administered by the State. It would not affect decision making as no real liability exists for our City until the State legislature changes the contribution rates. The City has no input in funding decisions other than maybe lobbying the legislature and therefore the information is useless.
  - ii. I would like to respectfully point out that if only sophisticated users can understand the information in a CAFR it is useless for decision making by local governments that are generally run by non-sophisticated officials. This is 100% true at our City as the only financial statements useful for decision making are the modified-accrual governmental fund statements. GASB has rendered the proprietary funds useless for internal decision making.

## b. Your ability to assess a government's accountability?

i. I believe it is greatly diminished based on confusion to the reader. Adding information that is non-relevant to the statements being presented only adds confusion. For instance, presenting liability information for the plan as whole may lead a reader to assume we have greater liabilities than

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presented. GASB appears to believe more equates to better. I've found it generally equates to more confusion.

# c. Your ability to assess interperiod equity?

i. I again feel this is diminished.

### **Questions for Users about special Funding Situations**

# 11. Do you agree or disagree with GASB's proposals, regarding special funding situations? Why do you agree or disagree?

- a. I agree with the decision to show on-behalf payments only because it is already required by GASB standards and would therefore be consistent. The use of the word "substantial", however, should be better defined to clarify GASB's requirements if adopted.
- b. I feel GASB's examples of conditional and non-conditional funding situations are unclear and could lead to reporting errors or inconsistencies. Whether a government guarantees a percentage of payroll or a percentage of a revenue stream it collects as a funding mechanism, it still is specified funding source. A percentage of a revenue stream may change yearly in the amount but it still would appear unconditional as a type if it is guaranteed and collected consistently. A one-time grant or contribution from another entity would appear to better fit the definition provided for conditional revenues and accounted for as proposed. I feel the difference between conditional and unconditional revenues should be defined as whether contributions are a guaranteed, regular source to the plan versus a one-time or inconsistent type (grant or one-time contribution).

# 12. How would these proposals affect any or all of the following:

- a. The usefulness of the information to the analyses you perform, the work you do, or the decisions you make?
  - **i.** I believe it diminishes it. What is important to us is what we need to contribute, not what another party contributes.
- b. Your ability to assess a government's accountability?
  - i. I believe it is diminished as the participants are reporting revenues and expenses that are not reflective of what the participant actually realized.
- c. Your ability to assess interperiod equity?
  - i. Doesn't appear to affect interperiod equity as an offsetting revenue and expenditure does not affect equity.

# **Questions for Users about Defined Contribution Pensions**

- 13. I agree with the proposals.
- 14. No effects believed as there are no changes proposed and the reporting is reasonable.