

Letter of Comment No. 145 File Reference: 34-E Date Received: 10/12/11

3880 Salem Lake Drive, Suite H Long Grove, IL 60047-5292 p: 847/719-6500 f: 847/719-6506

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

To: Director of Research and Technical Activities, Project No. 34 – E & No. 34 – P

These comments are in response to the request for written comments on the Governmental Accounting Standard Board (GASB) Exposure Drafts – Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25 and Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27. The following comments were developed through the coordinated efforts of members of the Conference of Consulting Actuaries' (CCA) Public Plans Community and are being submitted to the GASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA Board, the CCA's other members, or any employers of CCA members, and should not be construed as being endorsed by any of the aforementioned parties.

The CCA Public Plans Community (PPC) represents a broad cross section of public-sector actuaries whose extensive experience with public plans provides the framework for our response. The PPC includes over 50 leading actuaries whose firms are responsible for the actuarial services provided to the majority of public-sector retirement systems. The following comments reflect a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans.

As you will see, our comments are extensive and detailed. Our membership includes a diversity of opinions and perspectives on public pension plan valuation issues, such that not all of our community, necessarily, subscribe fully to all the comments presented here. Nonetheless we believe the overall response reflects a substantial consensus among the actuaries who provide valuation and consulting services to public pension plans.

We are grateful to the GASB and project staff for their hard work in striving to understand these complicated and interconnected issues.

Paul Angelo, FSA, FCA, MAAA, EA (By Direction)
Chair of the Public Plans Steering Committee on behalf of the
Public Plans Steering Committee

#### Board of Directors

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Steering Committee of the Conference of Consulting Actuaries Public Plans Community 1

Response to the (GASB) Exposure draft of the Amendment of GASB Statement No. 25 & Amendment of GASB Statement No. 27.

### Major Issues and Concepts

To begin, we want to repeat our comments on the Preliminary Views where we commended GASB on selecting a measurement approach consistent with the long-term nature of the pension obligation and the career long nature of the employment exchange. We strongly endorsed the use of a discount rate based on the expected long term return on investments and the use of the level service cost allocation method known as Entry Age Normal<sup>2</sup>.

Also consistent with our comments on the Preliminary Views, our more critical comments and recommendations involve how changes in the pension obligation are translated into pension expense. The overriding issue that informs most of our comments is the practical consequences of GASB's decision to treat the annual allocation of the accounting cost of the pension obligation separately from the funding of those obligations. While we understand the rationale and are prepared to work with the result that annual pension expense will now be different than the annual contribution requirements, we urge GASB to maintain a realistic appreciation of two general consequences.

- 1. The need for the users of financial reports to be able to understand the relationship between these two measures of pension cost.
- 2. The need for pension plans and sponsors to be able to develop both accounting and funding information in ways that are reasonably practical, efficient and reliable.

These consequences require that, even if pension expense and contributions are ultimately different, they should still both be based on quantities that are practical to determine and that reflect the way pension costs and liabilities—whether accounting or funding—behave and evolve over time. Any differences should be well justified and straightforward to understand, and differences that are unnecessary or unduly burdensome to produce should be avoided.

The members of the actuarial profession are in a unique position in that we are the ones who will have to actually produce these new accounting measures and we are the ones who will be expected to explain how and why they differ from funding measures, which of course will still be needed. It is from this perspective we urge GASB to consider that, if in the details of implementation there is an established actuarial practice that is reasonably consistent with the goals of financial reporting, then financial reporting should follow the established practice rather than inventing new procedures that are, at best, unnecessary and, at worst, unrealistically difficult to implement.

By way of introduction, our comments first develop two higher level concepts that relate to the pooled nature of a pension plan, as distinct from more individually-based means of providing compensation and benefits. The first relates to the measurement of assets and the second to the measurement of changes in liabilities. We then discuss the substantial and complex compliance cost issues related to the new reporting requirements found in the Exposure Draft. This introduction is followed by detailed sections on technical, disclosure and multiple employer issues, all reflecting the practical perspective emphasized above.

<sup>&</sup>lt;sup>1</sup> These comments were developed through the coordinated efforts of the Conference of Consulting Actuaries' (CCA) Public Plans Steering Committee and are being submitted to the GASB by the Steering Committee of the CCA Public Plans Community. However, these comments do not necessarily reflect the views of the CCA Board, the CCA's other members, or any employers of CCA members, and should not be construed as being endorsed by any of the aforementioned parties.

<sup>&</sup>lt;sup>2</sup> Comment on terminology: GASB may wish to consider going back to the Preliminary Views approach of calling this method the "Entry Age method". While the traditional name in actuarial practice is "Entry Age Normal" the word "Normal" conveys no practical purpose. There GASB has an opportunity to advance actuarial nomenclature.

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#### Asset Measures for the Net Pension Liability

In the Exposure Drafts, the basic measure of the pension obligation is the Net Pension Liability (NPL) which is the difference between the Total Pension Liability (TPL) and the plan net position. For clarity in this discussion, we will refer to the plan net position as the Market Value of Assets (MVA), which for all purposes relating to this document will encompass the same meaning as fair value of assets. Because the NPL will be interpreted as the single and most basic measure of the pension obligation, we ask GASB to reconsider the use of a NPL based on the MVA for the fundamental reason that a MVA-based NPL would not provide a consistently reliable measure of the long-term nature of the pension obligation.

The problem with the MVA-based NPL is that it is the difference between two quantities, only one of which behaves like a long-term obligation. The TPL is relatively stable, consistent with the long-term obligation it measures, but the MVA is subject to short term fluctuations that are in no way comparable to the TPL or representative of the variability in the underlying long-term net obligation. As a result, the difference between TPL and MVA has all the volatility of the MVA and none of the long-term stability of the TPL.

We are aware that the Exposure Drafts address volatility in the MVA through a five-year deferral of unexpected investment returns when determining pension expense, just as certain changes in the TPL are also subject to deferred recognition. We suggest the GASB recognize that asset volatility is so much greater and more likely than liability volatility that its deferral mechanism should be incorporated directly into the NPL in order for the resulting NPL to better represent the long-term character of the pension obligation.

This could be accomplished by basing the NPL on an asset value determined as the MVA adjusted for the same five-year deferral of investment gains and losses that is provided for in the Exposure Draft for purposes of determining pension expense. The resulting adjusted NPL would then be made up of two similarly consistent components and thus, would present a more consistently reliable and decision-useful measure of the unfunded pension obligation.

Clearly this adjusted NPL could be calculated from information already provided under the Exposure Draft. The benefit of this variation is a reduced risk that the financial statement user will focus too narrowly on the volatile MVA-based NPL. If this approach is not deemed acceptable, we would propose that the deferred inflows and outflows of resources related to investments are displayed in the same schedule as the NPL. Under this approach, a resulting adjusted NPL could be included in the display. A description of this approach is included in our *Appendix A, Technical Comments*<sup>3</sup>.

Another aspect of comparing the TPL to the MVA involves the disclosure of funded ratios. Currently, there is only one funded ratio mentioned in the Exposure Drafts - one that compares the TPL to the Plan Net Position (i.e., the MVA), which is proposed to be shown in the Required Supplementary Information (RSI). Comparing the TPL to only the MVA may be misleading for all the reasons just discussed. We recommend showing the following two additional funded ratios which we believe would provide decision-useful information regarding the underlying relationship between assets and liabilities both from the accounting and funding perspectives:

- 1. TPL vs. Adjusted MVA (as described above) added to the Schedule of Net Pension Liability,
- 2. Funding Actuarial Accrued Liability vs. Funding Actuarial Value of Assets (AVA) shown on the *Schedule of Employer Contributions*.

<sup>&</sup>lt;sup>3</sup> It is our understanding that detailed schedules presenting this approach are included in the comments submitted by the American Academy of Actuaries, as developed by their Public Plans Subcommittee. We commend that discussion to GASB's attention.

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#### **Pooling of Plan Experience**

The Exposure Draft appropriately bases and measures the service cost and resulting TPL for each member on the projected benefits for that member, and then sums them over all participants to determine the total service cost and TPL for the plan. However there are some aspects of plan cost that result from the operation of the plan as a pooled vehicle for providing pension benefits. In particular, changes in TPL either due to demographic experience or assumption changes represent changes in the employers' pooled obligation. Accounting for these on a person-by-person basis ignores the fact that the plan, as a pooled vehicle, allows the employer to provide the benefit to the member with cost efficiencies that otherwise would not be available through individual benefit arrangements. This type of accounting leads to results that can misrepresent the actual experience of the plan and the resulting effect on an employer's financial obligation to the plan.

The clearest example involves the assumption as to when active members will retire. For this example, as is true for many public plans, we will assume that earlier retirements are more valuable than later retirements, so that when members retire earlier than assumed the plan experiences a loss, while retirements occurring later than assumed generate gains. Suppose that at a particular age the plan assumes a 20% retirement rate and that over the duration of one year, of the 10 members eligible to retire at that age, two retire and eight do not retire. Overall the plan has exactly met its retirement assumption and so there has been neither a gain nor a loss due to retirements occurring during that year.

In contrast, under the Exposure Draft approach, the gain or loss is determined separately for each member, and then amortized<sup>4</sup> (or not) based on the active or inactive status of the member. In our example, the eight members who did not retire would generate a gain while the two who did retire would generate a loss. If we base amortization on status as of the valuation date, the gains would be partially deferred while the losses would be expensed immediately. This would probably result in a net expense charge even though there was no retirement gain or loss, that is, no unexpected change in the TPL due to retirements for the plan overall. As a result, not only is the approach required under the Exposure Draft inconsistent with plan experience, it also requires calculations that are not required or even developed for any other purpose.

Generally we recommend that GASB recognize that, unlike the expected allocation of service cost, the pooling of plan experience, which is an essential determinant of the cost of services for benefits provided through the retirement plan, does not end with the career of an individual member. This leads to the conclusion that remeasurements of the cost of services (through gains and losses and through assumption changes) should be allocated to a period generally representing the service of active members, without introducing an otherwise unnecessary separation between the experience of active and inactive members. It also indicates that the allocation period should represent the pooled future service of all active members, and not attempt (as in the weighted amortizations proposed in the Exposure Drafts) to reproduce an amortization of each individual active member's experience over his or her service.

**Appendix A, Technical Comments** discusses in more detail these situations where focusing on plan experience one member at a time leads to unexpected and arguably unintended results requiring calculations that otherwise have no practical usefulness. These are the situations where GASB should consider that established, available measures and procedures currently in use would substantively accomplish their conceptual intent in a practical manner consistent with the long-term, pooled operation of the pension plan.

<sup>&</sup>lt;sup>4</sup> The process 'amortize' might be more generally described as 'recognize' under the ED because of the separate treatment of interest cost. We will use the two terms interchangeably in this response.

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#### **Cost of Compliance**

We appreciate the significant effort of the GASB to develop the proposed elements of the Exposure Drafts so as to reflect a "conceptual framework". However, in many areas this fresh start approach to the specific procedural and computational details would create a substantial and arguably unnecessary administrative burden which, in turn, would be cost prohibitive to plans and/or the individual employers. While this is true for single employer and agent multiple employer plans, it is especially true for cost-sharing multiple employer situations. We have detailed these issues in our comments along with suggested alternative approaches that we believe reasonably comply with the conceptual intent but in a more practical and cost-effective way.

As examples, three major elements that reflect significant complications and attendant additional costs are as follows:

- 1. Situations where a cost-sharing multiple-employer plan's contributing employers' fiscal year-ends do not align with the plan year-end will require not only additional actuarial calculations but, more significantly, multiple year-end asset valuations, including audits of those asset valuations.
- 2. For cost-sharing plans, whatever method is used, the need to determine the individual employers' proportionate shares and the application of the proportionate share to all identified employer disclosures will generate unprecedented costs for these employers.
- 3. The significant increase both in the notes to the financial statements and the RSI, both at the plan and employer level, will entail substantial additional cost.

Who is responsible for the increased cost of employer compliance? These significant additional costs raise a new issue; more exactly, they bring a new level of significance to the old issue of who bears the administrative responsibility and the cost for an employer's compliance with pension accounting standards. Under the current Statement No. 27 regimen, the information needed for the employer's financial statements is an immediate by-product of the actuarial valuations required and paid for by most plans. For this reason, most employers do not need to separately retain either the plan's actuary or a separate actuary to obtain required disclosure information, and the relatively low cost of its production is borne by the plans.

Many of the new calculations required by the Exposure Drafts, including some of the more difficult to obtain results, would now be needed solely for the employer's financial reporting and are not otherwise needed for the operation of the plan. This will raise the legal question of whether the costs for such actuarial services can be paid out of the plan's assets, which in turn may raise IRS plan qualification issues. Conversely, if the plan contracts the services yet charges the cost of these services back to the employers (assuming the plan has the ability to do so), would the employers have access to adequate resources to pay for the additional work? Furthermore, if the individual employers decide to contract these services independently, they may not have access to the actuarial resources needed to provide such services, especially if there is reluctance to have the same actuary retained by both the employer and the plan. Finally, because the actuarial results would now be part of the audited financial statements (as opposed to part of the RSI) the employer's financial auditor may also feel the need for independent actuarial capacity.

While at some level the actuarial profession might appreciate all this additional work, the actuaries involved with this response, in fact, are very concerned with the introduction of multiple, redundant and potentially conflicting actuarial functions the proposed standards would require for the operations of these plans. For this reason, which is consistent with both our initial comments above, and GASB's transparency objective, we believe GASB should attempt wherever possible to have the details of employer pension expense calculations be as consistent as possible with the actuarial calculations already required by the plans.

We have included in *Appendix B, Additional Required Services/Work*, a summary of additional work required to meet the proposed standards. If GASB is proposing to add this much complexity and cost to the production of employer financial reporting information, then GASB should be certain that there is correspondingly significant improvement in the practical decision-usefulness of the information, so as to justify both the substantial additional costs and any requisite shift of those costs from the plan to the employers. In particular, to the extent that the Exposure Drafts require new and more complicated calculations, GASB should consider whether already available measures and procedures would provide equally useful information.

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Throughout our comments above and in the following sections, we attempt to provide a constructive and informed analysis of the Exposure Drafts. Along with each comment, we also offer solutions and/or alternatives to each of the identified issues. In the context of each issue, we ask the Board to consider whether these Exposure Draft provisions are in practice consistent with the Board's declaration that, through these proposed reporting standards, their stated objectives have been met (pages xii and xiii of Exposure Draft No. 27). For example, we believe that the focus on changes in individual rather than pooled liabilities and the resulting amortization provisions can obscure the desired outcome of providing information to assess *interperiod equity*. As another example, basing the NPL on the MVA can be seen to impair the *decision-usefulness* of the basic measure on which the new reporting is based, as we believe it is not representative of behavior of the underlying pension liability.

Many of our comments trace back to the conceptual framework used to develop the proposed requirements. As actuaries, we are very familiar with the balance often required when applying a conceptual quantitative approach to real world scenarios. In such cases, procedures that may seem a reasonable application of the underlying concepts to a particular situation can sometimes lead to an impractical level of calculation and detail. We believe this to be the case regarding some elements of the proposed standards, as in practice they will require an overwhelming level of detail and implementation guidance without a comparable improvement in the *decision-usefulness* of the information that we can see. Considering the broad spectrum of those sponsors subject to the proposed requirements, we would support an approach of less detail and thus, less need for detailed guidance. Otherwise varied interpretations will result and, with variability, a possible loss of *consistency* and *transparency*. Added complexity and volume of information were proposed in the form of new note disclosures and RSI to satisfy the goal of accountability, yet employers may lack the ability to obtain all the necessary information. Without adequate resources and access to able staff to perform the required tasks, auditors and users of financial reports could question the reliability of the information and, in connection, *decision-usefulness* and *comparability*, if accuracy of the information is in question. Finally, as discussed above, the consequences of the additional work required to gather and disseminate the proposed disclosure information could result in time-delays, and ultimately result in a decrease of *transparency* and *accountability*.

The next three sections of our comments address *Technical Issues*, *Disclosure Issues*, and *Multiple Employer Issues*. These sections are followed by appendices detailing the issues raised. We look forward to discussing these issues with GASB and the project staff.

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### Technical Issues

This section lists a number of technical issues with comments and technical recommendations regarding how the items should be calculated, derived, implemented or disclosed. For further detail regarding our comments and recommended resolutions, please see *Appendix A, Technical Comments*.

#### Move Deferred Amounts Closer to NPL

As discussed in the *Major Issues and Concepts* section, we believe the NPL should be based on the same smoothed asset value as is described and calculated for purposes of the Pension Expense. Absent that change, any closer linking of the smoothed asset value to the NPL would improve the disclosure items. In particular, disclosing the pension related items in closer proximity to each other would present a comprehensive measure of the effect of the pension plan on the employer net position, a measure that currently is lacking. One approach would be to have the deferred inflows of resources and deferred outflows of resources appear on the financial statements just below the market value based NPL, with a final item combining all three resulting in an adjusted NPL, reflecting the smoothing as it is used to impact expense. For further detail regarding our recommendations, please see *Appendix A, Technical Comments*.

#### Amortization/Bases—Actives/Inactives

Liability differences resulting from changes in actuarial assumptions and experience gains/losses are closely related and are appropriately considered a "recalibration" of plan liability. Periodically, a pension plan will undergo an experience study, where analysis of multiple years of experience data results in a change in assumption and a corresponding remeasurement of liability. Similarly, experience gains and losses determined as part of the pension plan's (typically) annual valuation measure changes in liability as a result of the demographic experience during the period since the last valuation. In both situations, a "recalibration" of plan liability occurs, either based on more short-term recent actual experience or on a more long term reassessment of future experience.

As the GASB ED No. 27 now stands, there is a requirement to segregate liability changes, whether due to changes in assumptions or to recent plan experience, between changes due to retirees and inactive members and changes due to active members. Most actuarial systems are not currently programmed to perform such a segregation, and the calculation, even when possible, is such that different actuaries may perform or interpret the task differently.

If this segregation is required, then regarding one element of the task, we strongly recommend identifying gains and losses attributable to members retiring from the active population during the year, as changes attributable to active members, not retirees. The main reason for this recommendation was described in the Pooling of Plan Experience section above, and reflects the fact that this element of plan experience is measured over all active members who could have retired during a year and so should be based on the combined experience of members who do or do not retire.

This recommendation is further based on the fact that gains and losses attributable to inactives and retirees typically reflect primarily variances in the expected versus actual mortality regarding members who are already in receipt of their benefits (i.e., retirees and beneficiaries) and to a lesser extent the expected versus actual benefit commencement dates for other inactive members. This would argue for determining the experience gain or loss for the retirees and inactive members first (which is relatively straightforward) and ascribing the balance of the year's gains or losses to the active members.

If the segregation of liability changes between actives and retirees is retained in the final requirements, additional guidance would be required regarding preferred methodology to do so, and as a result, the pension plans probably would be held responsible for at least a portion of the research and development costs to build these functions into existing actuarial valuation software.

On a related issue, we believe that the GASB should reconsider the approach taken with the gains and losses for inactive and retirees attributable to both changes in assumptions and plan experience. We believe that these changes in liability for this group should not be immediately recognized, but rather amortized, as is proposed for the same type of liability changes attributable to active members. This relates to the concept explained above—that all these liability differences stem from a recalibration of plan liabilities, which is an ongoing effect of the pooling of plan experience for all members.

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We also feel that since it is an ongoing effect, the recalibration has a relationship to periods beyond the period in which the recalibration takes place. With that in mind, we feel it could be argued that the amortization period should be set to the same length of time used to amortize changes in liability for the active population, thus simplifying the calculation and removing the potentially difficult and ambiguous bifurcation of the identified changes in liability for actives versus retirees. Another option would be to segregate the liability changes, as directed (with the exception noted above), and amortize the active members' portion over the weighted average future working lifetime (AFWL) and the inactive/retiree portion over the average future life expectancy of the inactive/retiree member group.

Regarding the determination and use of the weighted AFWL, we believe that in practical application this procedure has a variety of unexpected difficulties. Please see *Appendix A, Technical Comments* for a more detailed discussion; however, in general terms, we question the appropriateness of applying weighting when determining the AFWL amortization period. The weighting, we believe, could affect the calculation of the average so as to reduce the amortization period by 30% or more. As noted in our opening section, this unexpected and unrepresentative result comes from attempting to reproduce a result based on individual member calculations, which is inconsistent with the cost dynamics of a pooled vehicle like a pension plan.

This is yet another area that could be inconsistently interpreted by the actuarial community given the differences in possible methods for determining an AFWL and of varying valuation software. If the current proposal on this issue is adopted, there would need to be a clarification of the preferred methodology and, in order to incorporate the methodology, the pension plans probably would be held responsible for at least a portion of the research and development costs to build these functions into existing actuarial valuation software.

All of these difficulties could be avoided and a more reasonable and intuitive result obtained by using a simple, unweighted AFWL as the amortization period for all liability changes from either gains and losses or assumption changes. Furthermore, in comparison to the calculation of the current Annual Required Contribution or ARC, which allowed up to a 30-year amortization for all unfunded liabilities, the Board's proposed use of AFWL as the amortization period for determining Pension Expense, even when unweighted and applied to all liability changes (other than plan amendments) as in our recommendations above, results in achievement of at least two of the Board's major objectives—improvement of accounting and financial reporting and reduction of unnecessary complexities.

#### **Treatment of Investment Expense**

Regarding the development of pension expense, depending on whether or not the expected rate of return is declared as "net of administrative expenses", it may be inappropriate to have a separate line item for "Administrative Expenses". We recommend adding language to the proposed requirements recognizing that if the long-term expected rate of return is net of administrative expense, in essence, the service cost item would include the assumed element of expenses and no additional line item within Pension Expense would be necessary.

#### Permitted Use of Ongoing Allocations/Attribution Methods

As members of the CCA Public Plans Community, we feel strongly that if a cost-sharing plan has a reasonable and reliable attribution method in place for purposes of allocating liabilities, assets and/or contribution requirements, then the plan should be allowed to continue the practice as long as a complete description of the method of allocation is included in the notes to disclosure. Continued use of established allocation practices based on employer-specific assets and liabilities would enhance accountability and interperiod equity, as well as comparability among pension plans and employers.

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#### **Less Common Benefit Structures**

There exist a few additional types of benefit plans and/or benefit structures for which we would appreciate guidance to be included within the final disclosure requirements. For example, a number of our members have clients with fixed dollar pension plans, meaning that the benefit itself is not dependent upon salary, nor is it influenced by or adjusted for inflation. These particular situations were not specifically addressed in the Exposure Drafts, but there is discussion in paragraph 26 of GASB ED No. 27 (and paragraph 44 of GASB ED No. 25) that states, "...if an employee (member) does not have projected pay, the projected inflation rate should be used in place of the projected salary increase rate." As this does not really reflect the situation of a fixed dollar benefit plan, we would prefer that this type of plan be directly addressed in the final regulations. Other examples of benefit structures not addressed in the proposed regulations include:

- 1. A Length of Service Award Program (or LOSAP),
- 2. A Deferred Retirement Option Plan (or DROP), specifically with regard to the calculation of the normal cost; and
- 3. An unfunded qualified plan.

We would appreciate clarification as to whether and how the proposed standards apply to these types of plans and/or benefit structures. For more detail on the specific questions and comments regarding these types of plan structures, please reference *Appendix A, Technical Comments*.

#### **Expected Investment Rate of Return**

We believe there is an implicit misunderstanding pertaining to the use of expected geometric mean rates of return to develop the investment return assumption, as shown in *Illustration 3*, page 50 of the GASB ED No. 25. Under the building block approach, as it turns out, one cannot weight expected geometric mean returns by asset class to derive an expected geometric mean return for the portfolio. This could be corrected by saying that the example is using best estimates of *arithmetic* returns. Please note that our point here is not to express a preference for either arithmetic or geometric returns as the measure, but rather that the example should use them in a technically accurate way.

More generally, we believe the GASB ED No. 25 is too limiting in scope when describing accepted methods to develop the plan's long-term expected rate of return assumption. As further discussed in the *Disclosure Issues* section of this report, not all plans develop investment return assumptions using an asset class-by-class assumed return; therefore, a building block approach is not appropriate for use in all cases. It is simply one method among many used in the industry and so may not be relevant if other methods are used. For more details regarding methods to develop a long-term expected rate of return assumption, please reference *Appendix A, Technical Comments*.

#### Time-Weighted Rate of Return/Money-Weighted Rate of Return

Pursuant to the discussion in paragraphs 85 and 86 of GASB ED No. 25, the Board's research led to the belief that a time-weighted return was a more appropriate basis for comparison to relevant benchmark rates, and that it would provide better information to assess investment manager performance, as well as provide comparability among plans and investment managers. However, it often is difficult for a plan to obtain the necessary elements required to calculate the time-weighted rate of return as depicted in *Illustration 1a*, page 38 of GASB ED No. 25. The Board also determined that a money-weighted return would provide a better comparison to the long-term expected rate of return of plan investments. The typical reality is that when these two methods are used to determine rates of return on large asset bases with consistent periodic cash flows, they will not produce a significantly different result, especially for single year returns. Therefore, the presence of single-period returns calculated under both methods will not improve the decision-usefulness of the information. We recommend the Board choose only one method for inclusion in the disclosure requirements. Furthermore the Board should consider requiring the annual rate of return information be shown on the *Schedule of the Employers' Net Pension Liability*, thereby simplifying the plan's and each employer's notes to financial statements and RSI.

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#### **Disclosure Discount Rate Calculation**

We would like to acknowledge the GASB's efforts in their development of the method proposed to determine the disclosure discount rate. We believe that there are a few technical issues regarding the calculation of the discount rate that may require additional guidance in the final disclosure requirements, but in general, the basic concept encompasses a thoughtful balance of on-going responsibility to the public trust, a long-term investment horizon and capital market influence. The potential issues most likely would originate from plans with rolling amortizations, plans which are poorly funded and plans with a high retiree/active ratio.

The projection of plan assets to depletion date is unnecessary and impractical for many plans receiving contributions according to an actuarially determined funding policy. We recommend that the GASB provide for an exemption in the final accounting standards from the requirement to provide a date of depletion of assets and from the exercise in general as long as the plan provides:

- 1. Background on the adopted funding policy and the actuarially determined contributions; and
- 2. Sufficient contribution history that supports the adherence to the funding policy.

In addition, we believe it may be difficult to find an applicable 30-year municipal bond rate for use in the calculation.

Regarding multiple employer plans, we recommend it be made clear in the final disclosure statements that the disclosure discount rate must be determined at the plan-level to avoid any issues or disagreements with the individual employers regarding assumptions, cash flows and appropriate municipal bond rates.

For more details regarding the discount rate calculation, please reference *Appendix A, Technical Comments*.

#### **Actuarial Standards Board**

Please note that the Actuarial Standards Board is an autonomous Board. Therefore, we recommend the removal of the words "...of the American Academy of Actuaries." following "...Actuarial Standards Board..." appearing in paragraphs 19 and 50 of GASB ED No. 27 and paragraph 38 of GASB ED No. 25.

#### Newly Required Calculations Can be Burdensome and Expensive

As discussed in the *Major Issues and Concepts* section, the elements of the Exposure Drafts would involve a significant amount of additional work not currently required, and thus, would cause a significant additional expense related to the staff of the plan administrators and the staff of affiliated employers. In addition there would also be additional expenses for services of various plan vendors, including actuaries, accountants, auditors, attorneys and investment/trust service providers. Please see *Appendix B, Additional Required Services/Work* for a summary of the additional service and work that would be required if the Exposure Drafts were adopted as is.

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### Disclosure Issues

#### **Support of Investment Return Assumption**

Paragraph 31.b.(1)(b) of GASB ED No. 25 and paragraphs 34.b., 67.b., 87.b. of GASB ED No. 27 require disclosure of the long-term expected rate of return on plan investments and a description of how the long-term expected rate of return was determined. The Exposure Drafts only provide one method, often referred to as the "building block" method, to be used for supporting the long-term expected rate of return. We believe allowing only this method, although popular, is not applicable for use by <u>all plans</u> to sufficiently support the long-term expected rate of return assumption. We propose that the plan be allowed use of the method actually enlisted to develop the long-term expected rate of return, and that the method be illustrated in the year-end disclosure for the following reasons.

- Not all plans develop their expected investment return assumption using asset class-by-class assumed rates
  of return, nor are they required to do so under current or proposed Actuarial Standards of Practice. To
  require disclosure using a method that does not represent the actual basis for the assumption would be
  confusing and misleading.
- 2. Investment advisors who prepare the most sophisticated expected investment returns for a number of plans are often reflecting a shorter time-horizon than the actuaries providing advice on the final long-term expected rate of return assumption. The adjustment from a shorter to a longer investment horizon may not necessarily be prepared by asset class. In this scenario, again, the disclosure would not represent the actual basis for the assumption.
- 3. For many sophisticated models of future expected investment returns, the expected investment return for the entire portfolio is not the sum of the products of the percentage allocated to the asset class and the expected investment return for the class. Instead, the expected portfolio investment return reflects anticipated rebalancing between classes over time. Therefore, presenting expected investment returns by class that don't add to the expected portfolio return will more likely cause confusion than provide useful information.

#### +1%/-1% Disclosure

Paragraph 31.b.(1)(e) of GASB ED No. 25 and paragraphs 34.e., 67.e., and 87.e. of GASB ED No. 27 require disclosure of the impact on NPL of a one percent increase in the blended disclosure rate and a one percent decrease in the blended disclosure rate. Our primary concern in supplying these values is that it requires two additional substantial actuarial calculations, each of which would cause the plans to incur a significant actuarial expense. Furthermore, if this element of disclosure is retained in the final disclosure requirements, we believe there must be additional language clarifying that the one-percent adjustments are to be differences in *real* rates of return, and not by changing the underlying inflation assumption. If the underlying inflation assumptions were changed instead, adjustments would be necessary to other economic assumptions as well, which we do not believe is GASB's intention.

#### **Duplicate Information**

The RSI disclosures under paragraphs 42.a. and 42.b. of GASB ED No. 27 include a considerable amount of duplicate information, specifically in the *Schedule of Changes in the Net Pension Liability* and *Schedule of Net Pension Liability*. We ask the GASB to consider condensing the two schedules into one to reduce work and to simplify the production of yearend disclosures for plans and employers alike.

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#### Collective Schedule of Changes in NPL

Paragraph 70.a. of GASB ED No. 27 requires cost-sharing employers to present a 10-year *Schedule of Changes in the Collective Net Pension Liability* in their RSI. We recommend either removing this schedule or, as a second choice, showing a simplified or summarized version of the plan information. If an employer's year-end date parallels the plan's year-end, the collective plan information would be available in the plan disclosures and so shouldn't be required for inclusion in the employer disclosure. If an employer's year-end date differs from the plan's year-end date, the collective plan information proposed to be shown in the employer's disclosure would not tie into the final disclosure for the plan and may only confuse the reader. We suggest the same logic be applied to the RSI requirements for non-employer contributing entities in unconditional special funding situations.

#### **Collective Plan Schedules**

In addition, we believe there is no need to show the total (collective) plan schedules—*Schedule of Net Pension Liability* and *Schedule of Employer Contributions* together with the equivalent schedules illustrating the employer's proportionate share. Again, if an employer's year-end date parallels the plan's year-end, the collective information would be available in the plan disclosures. If an employer's year-end date differs from the plan's year-end date, the collective information shown per employer would not tie into final disclosures for the plan and may only confuse the reader.

### NPL and/or Pension Expense in Conflict with State Statute

Some states have laws disallowing deficit spending, or perhaps a requirement to maintain minimum balance sheet ratios. In these situations, recognition on financial statements of NPL may leave employers or entities non-compliant with such laws. A similar problem can exist with deficit spending restrictions and the pension expense. The GASB may want to consider providing guidance for use in these special situations; otherwise, the government entity in question eventually may declare that it will not adhere to the GASB's requirements, defeating the fundamental purpose of improving accounting and financial reporting and perhaps causing financial hardship for the entities.

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### Multiple Employer Issues

### Participating Employers with Different Fiscal Years from the Plan

With respect to situations where a cost-sharing employer's fiscal year-end differs from the plan year-end, while we are conceptually comfortable with the idea of liability roll-forwards, we challenge the need to re-value trust assets or roll-forward pension liabilities when the employer's year-end is not excessively distant from the date of the plan's audited year-end asset valuation. The act of providing for and funding a defined benefit pension plan is a long-term endeavor. Due to the long-term nature of the commitment, we believe there is no need to perform additional asset or liability valuations, unless of course, there exists one or more significant events that would merit such a re-valuation or roll-forward.

Within most cost-sharing pension plans, there is a high likelihood of multiple fiscal year-ends—up to 12—considering the entire body of participating employers. To follow this proposal to the letter, multiple asset valuations would need to be performed on assets of the total trust fund. Such frequent valuations would likely prove challenging insofar as they would require ongoing and timely valuation of illiquid assets held in hedge funds, private equity and real estate asset categories. It is likely that the practical difficulties associated with valuing such assets would delay reporting to employers, as there are long delays after each quarter-end asset valuation and it is virtually impossible to obtain asset valuations for non-quarter ending months. In summary, each valuation would translate to significant time, effort, and administrative and audit-related costs for the fund, as well as, similar burdens of staff-time and auditing cost elements on behalf of the individual employer.

The various asset valuations and roll-forwards of liabilities also would create an inconsistency between total disclosure amounts published for the pension plan and the amounts disclosed in the employer-specific (proportioned) disclosure information. Because of the long-term nature of a pension plan and the additional administrative costs and reporting complexities of the proposed requirements, we believe it would be sufficient for individual participating employers to use asset and liability valuation results calculated at the plan's year-end provided:

- 1. The employer's year-end is within a 12-month period of the most recent valuation of the trust assets; and
- 2. No subsequent significant events have occurred.

For cost-sharing plans that perform bi-annual valuations, we propose the requirement of a single one-year roll-forward of liabilities and re-valuation of assets at the "off-year" plan year-end. These values would then be used by all participating employers with year-end dates falling within the "off-year" 12-month cycle.

#### Calculation of Cost-sharing Employers' Proportionate Shares

Although viable in theory, the proposed method for calculation of cost-sharing employers' proportionate shares of collective employer contributions is cumbersome and unrealistic when it comes to calculation and dissemination of the proportionate share values to large numbers of employers. The proposed method is to base the proportionate share on each employer's projected long-term contribution effort compared to the total plan projected long-term contribution effort, which is difficult to determine since the "projected long-term contribution effort" is not well defined within the GASB ED No. 27. Paragraphs 46 and 80 do not specify the time frame of the projection period over which the contributions are to be measured, nor do they mention the precise method to be used to perform the calculation. Considering that many plans have multiple benefit tiers and variable contribution rates, a good-faith effort at developing the employer's "projected long-term contribution effort" would be very complex and the results of such a calculation could vary significantly depending upon the projection period selected as well as whether anticipated future members were included or excluded. We note that the same concerns extend to non-employer contributing entities.

In uncomplicated situations, we would propose that the proportionate shares be based on either i) employers' prior-year compensation or contributions or ii) employers' current-year anticipated compensation or contributions. Either basis would enable employers to determine their own proportionate shares with minimal input from the plan. We recognize that not all participating employers will have "uncomplicated" situations. Accordingly, we believe there may be a need for one or more safe-harbor methods for plans with unconditional special funding situations, cost-sharing employers with a

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defined or limited contribution time commitment, or employers who, for various reasons, have significantly uneven projected contribution patterns.

We recommend a safe-harbor method that bases the proportions on the present value of each contributing entity's total projected contributions over the period in which the NPL is projected to be financed based on all future contributions. This calculation would be based upon the same actuarial assumptions used in the calculation of the NPL. If the NPL is not projected to be financed over any future period, then the present value of future contributions could be calculated over the next 20 years, or another period the GASB believes is more suitable. Adoption of either of these alternatives would make it clear that cost-sharing employers are not tasked with calculating the present value of future contributions extending into eternity.

Another safe-harbor may be desired for allocating NPL and pension expense for the employees of terminated employers who no longer have an obligation to contribute. One possible simplified approach would be to refrain from allocating these assets or liabilities to other employers. The GASB might want to permit use of this method only when assets and liabilities allocated to terminated employers do not comprise more than 2% of the total. Another possible simplified method would be to perform a pro-rata allocation of all elements based on the other employers' and non-employers' proportion of NPL.

Finally, some plans that meet the GASB definition of cost-sharing ("plan assets can be used to pay the pensions of the employees of any employer") nonetheless determine separate costs for different employers based on allocations of plan assets, service costs, liabilities, etc. If a cost-sharing plan has already performed such allocations by employer for the purpose of setting employer-specific contribution rates, we recommend that those allocation bases should be permitted for use in allocating NPL and pension expense, rather than the proportionate shares approach.

### Tracking Deferred Inflows/Outflows of Resources by Employer or Entity

As described in the GASB ED No. 27, there is an inconsistency between collective pension expense and an individual employer's (or governmental non employer contributing entity's) pension expense. If annual differences between proportionate shares and actual contributions, as described in paragraphs 60, 61, 80 and 81 are identified and amortized at the level of the contributing entity but are not recognized at the collective level, then the sum of the parts will not equal the total. Although it could result in more volatile entity-specific pension expense, we propose immediate recognition of these differences, by employer or entity, and deletion of these four paragraphs from the final Statement. The benefit gained from segregation and recognition of these amounts within the individual employer's or entity's pension expense is minor compared to the additional effort required to implement the proposed ongoing calculations to do so. In addition, the required calculations would quickly grow in complexity and thus require calculation by the plan's actuary, increasing costs to the plan of providing required information to the contributing entities. As a compromise, the differences could be calculated and reported in the Notes to Schedules (as in Illustration No. 3 on page 129 of GASB ED No. 27) but not included in deferred outflows of resources and deferred inflows of resources or amortized as a component of pension expense.

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#### Coordination

The proposals in the GASB ED No. 27 would require significant coordination between plan administrators and contributing entities. Large amounts of information would have to be disseminated to and collected from contributing entities by the plan. This task could prove difficult if the plan does not currently maintain a relationship with all contributing entities. For example, if one school district performs accounting and administrative responsibilities for another school district and remits contributions to the plan in one transmittal in lieu of each school district remitting its own contributions, the plan may not have an ongoing relationship with the non-remitting school districts. Similarly, there may be contribution agreements qualifying as special funding situations that are not known to the plan administrator or simply unusual reporting responsibilities that do not neatly conform to the primary government/component unit reporting hierarchy. A few additional examples of unusual reporting relationships are provided below:

- 1. Component Unit with a different year-end than the Primary Government through which it reports,
- 2. Classification of employees participating in multiple plans,
- 3. Special Funding Situations between employers but contribution dollars not directly remitted to plan,
- 4. Special Funding Situation regarding a state where the plan's actuary and the state's actuary do not agree on the amount of the obligation of the state to the plan,
- 5. State subject to a Special Funding Situation but consistently raises employee contributions to avoid contributing to the plan,
- 6. Plan covered Component Unit that is a Component Unit of a Primary Government not covered by the plan; and
- 7. Employers who participate in more than one plan and the plans have different year-end dates.

Finally, for plans that have members who work for multiple participating employers, the GASB ED No 27 does not include specific instructions for the treatment of these situations. If the plan counts such an individual under the employer who makes the highest contributions on his or her behalf, but each employer counts the individual within the employer classes and number counts, the sum of the parts will not equal the whole, and, depending on the method used to calculate each employer's proportionate share, the inconsistent counts could skew the allocation of NPL and pension expense.

### Responsibilities of Plan vs. Employer

The GASB ED No 27 requires reconsideration of the question of whether it is the responsibility of the plan to provide financial reporting information to the individual employers and non-employers, as well as whether employers and non-employers have a choice of using information provided by the plan, or developing it themselves. Considering the added complexities resulting from the proposals delineated in GASB ED No. 27, there is some opportunity for differences between the plan and participating employers in opinions and interpretations. Given the nature of a cost-sharing plan, certain calculations, if performed from the viewpoint of the plan, produce results that may not coincide with those same calculations performed at the level of the employer. Furthermore, considering the often tenuous plan/non-employer relationship, more complex issues could result if a non-employer disagrees with the numbers developed by the plan. Elements of the proposed disclosure requirements that may lead to interpretation issues include:

- 1. Discount rate determination and the selection of an appropriate municipal bond rate,
- 2. Assumptions, such as payroll growth, contribution requirements (if not statutory) and all other actuarial assumptions affecting the calculation of total pension liability,
- 3. Determination of contributing entity's proportionate share,
- 4. Collective pension expense,
- 5. Inclusion/Exclusion of ad hoc COLAs in the total pension liability; and
- 6. Employee member counts within classes of employees.

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If employers or non-employers decide not to use plan-supplied information, the opposite of GASB's desired outcome may result in that the disclosed accounting information will lack internal consistency and general reliability. Those responsible for a plan's accounting disclosures should have a sense of whether and when it has met the accounting disclosure requirements and employers should have a viable means of supplying dependable information that is reasonably easy to obtain or derive. Therefore, as previously discussed in our *Major Issues and Concepts* section, we believe increased decision-usefulness will be gained by simplifying the proposed requirements. Please see *Appendix C*, *Simplified Solution to Multiple Employer Reporting Issues* for our recommendations regarding this area of concern.

#### **Timeliness of Reporting**

In addition to the potential for substantially increased costs, as discussed in the *Major Issues and Concepts* section of these comments, the proposed method of production of pension-related disclosure would result in excessive reporting delays. Although not as disruptive to employers of single employer plans, employers of cost-sharing and perhaps agent plans would be significantly impacted by the adoption of the Exposure Drafts as written. If an employer had to wait for a roll-forward of pension liabilities, plus a pension trust revaluation and ultimately an audit of the revaluation, on the average, it would result an approximate four-to-five month delay, when most employers produce their financial statements within one-to-three months of their fiscal year-end. See *Appendix B, Additional Required Services/Work*, for a summary of additional work required to meet the proposed regulations.

### **Summary of Simplified Approach**

To present a more comprehensive recommendation intended to resolve a number of challenges the GASB ED No. 27 presents for cost-sharing multiple employer plans and their participating employers, please see *Appendix C, Simplified Solution to Multiple Employer Reporting Issues*.

**Appendix A – Technical Comments** 

Appendix B - Additional Required Services/Work

Appendix C - Simplified Solution to Multiple Reporting Issues

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#### ١. Presenting deferred amounts closer to NPL

- A. The proposed balance sheet NPL is based on the Market Value of Assets, yet the expense factors in deferred inflows and outflows reflect a smoothed asset value. Assuming GASB stays with the use of Market Value of Assets to determine the NPL, the user of the financial statements should be presented the combined impact on the employer's net position of both the NPL and the deferred amounts.
- B. This could be accomplished by placing the reconciliation of the deferred amounts closer to the NPL value in the balance sheet information. At a minimum, we suggest that the chart on page 119 of GASB ED No. 27 be revised. We suggest that after "Balances – at 12/31/x9" GASB add two lines:
  - 1. Deferred Inflow/outflows
  - 2. Recognized Balances
- C. It is our understanding that a more detailed implementation of this suggestion may be contained in the Exposure Draft Comments submitted by the American Academy of Actuaries.

#### 11. Amortization of deferrals of inflows/outflows of resources (Actives) - portion of gains/losses due to assumption changes or experience different than expected ("gains and losses") for active lives

- A. Clarify that gains and losses due to retirement in the year of measurement should be included with active member gains and losses
  - 1. We understand that GASB wishes to treat the gains and losses for retirees separately from active employees. We would like to clarify the status of the gains and losses associated with those retiring in the "current year" as well as define the concept of the "current year".
  - 2. During any given year, a fraction of those eligible to retire will retire. Generally the sooner someone retires, the more expensive the benefit. Actuaries generally develop rates of retirement based on plan experience. If exactly the assumed numbers of people retire, there may be no aggregate gain or loss. However, this is not and can not be true by individual. Those who do retire tend to produce losses and those who chose not to retire produce gains. We think that both categories of this should be part of the "active employee" gain or loss. Said differently, the retiree gain or loss should be based on those retired at the beginning of the current year, with the remaining total gain or loss associated with the active members.

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- 3. This raises an observation as to how the use of roll forward liabilities affects the timing of recognition of gains and losses. Assume we need to disclose an NPL at 6/30/2014. For FY14 there will be a deferred inflow/outflow associated with "current" active employee gains and losses. This will not be based on FY14 experience since the 6/30/2014 actuarial valuation (valuation based on 6/30/2014 census) will not be completed. Most likely the results will be based on the 6/30/2013 valuation. The most recent layer of deferred inflows and outflows from actuarial gains and losses will be based on demographic experience from the 12 months ending 6/30/2013. The retiree gain or loss should be based on those retired by 7/1/2012 with the results rolled forward to 6/30/2014 to determine the NPL.
- B. Average Future Working Lifetime (AFWL) used as an amortization period
  - 1. The difference between the future working lifetimes on a weighted or un-weighted basis is about 30%. In addition, both may be shorter than the GASB examples show. We expect the average period is likely to often fall in the range of 7 (weighted) to 10 years (un-weighted). We are recommending that GASB allow the use of un-weighted amounts, as they are more consistent both with the user's understanding of what AFWL represents and with the pooled nature of the pension plan.
  - 2. If we are to weight the amortization period, it should be acceptable to weight it based on Actuarial Liability of the employees rather than the change in Actuarial Liability. The Actuarial Liability basis would be easier to calculate and the difference in how to weight future service (unlike the decision on whether to weight it) is unlikely to be material in most situations. However; once a preferred method is determined, at least a portion of the research and development costs to build this function into existing actuarial valuation systems would fall to the plans and/or employers of those subject to the new requirements.
  - 3. We have had discussions about what types of amortization methods can be used. We recognize a traditional "interest and principal amortization" method might not be anticipated since the interest cost is in a different part of the expense calculation. However this would not preclude an "interest and principal amortization" method, because for the amortization periods under consideration those amortization payments will always be greater than interest on the TPL.
  - 4. We are unsure about what type of aggregate amortization/recognition would approximate individual amortization/recognition (if that is in fact the intent). More importantly, it may not be clear that individual amortization/recognition produces a decidedly non-level recognition pattern. The following graphs illustrate what one of our members developed based on actual representative plan data to show how individual amortization/recognition would behave. We believe this constitutes as argument against such an individually based approach, and in favor of the more straightforward unweighted AFWL approach.

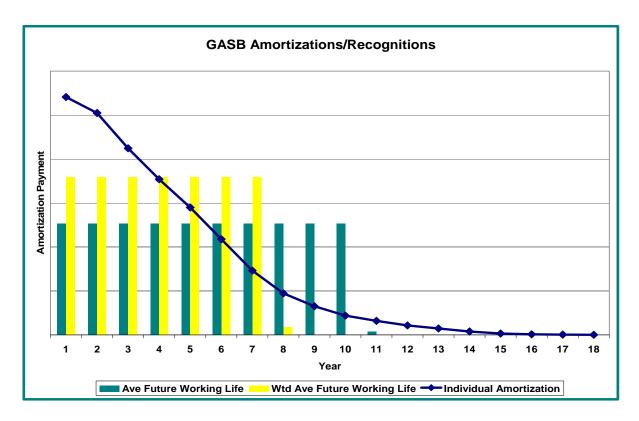
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5. The line on the graph below represents the amortization that would result by amortizing each individual's gain or loss over their individual expected future working life. The bars are the two alternatives discussed (unweighted AFWL in yellow and weighted AFWL in green) above using straight line principal amortizations. We suspect these patterns will be similar for most plans<sup>1</sup>. The extraordinarily front-loaded amortization under the individual approach results from the fact that the relatively large liability changes for members close to retirement are fully recognized early in the recognition period, leading to the steep decline after only a few years. This would appear to be inconsistent with the career-long employer-employee exchange that is the context of the Exposure Drafts. We suggest this also indicates against the use of the weighted AFWL, as that period is intended to approximate the individual amortization approach.



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<sup>&</sup>lt;sup>1</sup> Since these are just the principal payments (interest is taken care of as a separate component of pension expense), they do not represent traditional level % or level \$ amortizations.

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- III. Amortization of deferrals of inflows/outflows of resources (Inactives & Retirees) - in lieu of immediate recognition, consider amortizing impact changes for inactives and retirees due to "recalibration of pension liabilities" (assumption changes or gains and losses)
  - A. Amortize these changes in liability over AFWL same as used for amortization of deferred inflows/outflows of resources resulting from active member liability changes, or
  - B. Amortize these changes over Average Remaining Lifetime (ARL) of inactives and retirees
    - 1. We understand and support the concept behind not spreading the liability increase for retiree benefit improvements over future years. However, we believe that it would be appropriate if other changes in retiree liabilities (and other inactives) were spread over either the average future working lifetime of employees or the average remaining lifetime of retirees.
    - 2. This is more consistent with the nature of actuarial measurements and with the pooled aspect of the pension plan.
    - 3. On a practical policy level, we also think this would encourage good governance by not discouraging employers from adopting more conservative assumptions.

#### IV. Treatment of investment expense

- A. We would like GASB to allow plans to use a long-term expected return/discount rate net of administrative expenses as described in either example below. It is a common practice in many public sector systems to use a discount rate net of
  - 1. Investment expenses, or
  - 2. Investment expenses plus non-investment related administrative expenses.
- B. While we do not object to using an assumption that is gross of expenses, we have some concern that applying a gross discount rate and a separate cost of administrative expense (as is shown on page 120 of the GASB ED No. 27) would not be consistent with current practice that does not fund for expenses separately from benefits.

#### ٧. Request clarification within the proposals considering certain types of plans/benefit structures

- A. Permitted use of level dollar Entry Age normal cost, if benefit is a fixed dollar benefit
  - 1. Paragraph 26.b. of GASB ED No. 27 discusses Service Cost (Normal Cost) tied to pay increases or inflation. We understand the pay concept but it is not clear when it would be appropriate to tie this to inflation. Some plans have fixed dollar benefits not tied to pay or to cost-of-living.

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- 2. Established actuarial practice permits the use of a "level dollar normal cost approach" when benefits are not tied to pay. We suggest that a level dollar method be considered in these cases. If GASB feels that an inflation-based normal cost be determined, we ask that GASB provide more detail on when this would be used. We recognize that there some situations involving
  - a. Benefits equal to the greater of a fixed dollar benefit and a pay related benefit and either might be appropriate, or
  - b. A fixed-dollar benefit with a pattern of benefit improvements.
- B. Would a "length of service award program" (LOSAP) be considered a special funding situation?
  - 1. We would like the standard to clarify that it covers volunteer firefighter plans [LOSAP, see IRC §457(e)(11)] if the government is in practice funding these plans (either DB or DC style designs). Since volunteers are not employees, it is not clear that this standard as written would apply.
  - 2. These benefits are often small fixed dollar DB plans (e.g., \$6/month for every year of service); therefore, would a LOSAP plan qualify as a special funding situation?
- C. Deferred Retirement Option Program (DROP) When does DROP normal cost end?
  - 1. Some plans have a feature referred to as a DROP. There are at least two different ways to allocate Normal Cost during the DROP period for existing ARC and funding purposes:
    - a. Some plan actuaries use a method that funds for DROP by assuming that the date of entry into DROP is the date of retirement for purposes of determining the period over which the Normal Cost is allocated. Under this method the Normal Cost for anyone in DROP would be zero. This is a commonly used method; for example, we believe that this method may be used by all plans with DROPs in the State of Florida.
    - b. The second method is to allocate the Normal Cost through the exit date from DROP. This would require the projection of DROP benefit amounts and would continue the Normal Cost until the DROP exit date. Under this method the normal cost for anyone in DROP would not be zero unless they were assumed to retiree immediately.
  - 2. The GASB ED No. 27 states that, "The service costs of all pensions should be attributed through all assumed exit ages, through retirement." This raises the question as to which of the above methods (or possibly both) would meet this standard. We believe that method 2 seems to best meet the guidance provided by GASB to fund to exit ages. However, since many plans use method 1 for funding, we suggest that method 1 be acceptable if it is used for funding. Method 1 generally is more conservative and the difference is not material enough to justify changing the method for funding. More to the point, having this method difference as possibly the only difference between liability measures for accounting and funding is also a concern.

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D. Do the proposed standards cover unfunded qualified plans?

- 3. Paragraph 5. of GASB ED No. 27 discusses pensions paid "through qualified trust." There is a difference between
  - a. Non-qualified plans and
  - b. Qualified plans without any trust fund.
- 4. The Exposure Drafts state that they do not cover non-qualified plans. We would like GASB to clarify that they do cover unfunded qualified plans where benefits are paid solely through payroll systems (on a pay-as-you-go basis) and not from a trust fund. There are relatively few of these unfunded qualified plans (e.g., a few long closed plans, some judges plans). This is a bigger issue for Other Postemployment Benefits (OPEB) plans where many are unfunded.

#### VI. 30-year tax exempt municipal bond rated AA/aa (GASB ED No. 27 paragraph 22.)

- A. First, we would like to again say that we agree with the approach of using a blended rate in the situations suggested by GASB. As stated in the Exposure Drafts, if the plan's net position is expected to be insufficient to make all benefit payments that are projected to occur, the Exposure Drafts require the use of a blended discount rate, partially based on "an index rate for a 30-year, tax exempt municipal bond rated AA/aa or higher".
  - 1. Our key concerns are that
    - a. To our knowledge, such an index rate currently is not generally available, and
    - b. There may be a subscription charge or other fee for investment firms to provide this information.
  - 2. Furthermore, it is conceivable in the future that the universe of such bonds could be limited. When the Treasury Department developed the yield curve used for minimum funding requirement determinations for private sector pensions, they found only 277 corporate bonds with 15 to 30 year durations. The number of 30 Year bonds was probably much smaller than that.
  - 3. We would recommend broader language, for example, based on "long duration high quality municipal bonds". The Federal Reserve publishes weekly municipal bond yields for 20 years or more. This is a publicly available source of long term municipal bond yields and we would encourage language that would allow the use of this index as it may be the only such index that is currently free and readily available.

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#### VII. Long-term expected investment rate of return

- A. The example at the top of page 50 in GASB ED No. 25 needs to be corrected. The building block approach cannot be used to directly get to a geometric result (i.e., you cannot weight expected geometric mean returns by asset class to get an expected geometric mean return for the portfolio). If you want to use a geometric example, you need to use arithmetic mean returns by asset class in the building block approach and then state a time horizon (e.g., 10 years) and volatility adjustment (offset) to get to an expected geometric rate of 7.75%. We recommend that, as an alternative, you can use your example but simply say that the 7.75% return and the returns by assets class are all expected arithmetic mean returns.
- B. The building block approach is just one example of how the earnings assumption can be developed, and so the standard should not preclude other examples or methods. While we agree that the disclosure should include detail on how the assumption was developed, flexibility should be available to accommodate the methodology actually used. Also, the plan and actuary might want to use a rate more conservative than the median rate (e.g., a rate with a 60/40 expected success rate) for funding but this should not preclude them from using a mean or median rate for accounting.

#### VIII. Calculation of time-weighted rate of return

A. The calculation formula on page 38 of GASB ED No. 25 needs to be corrected. It is assumed there is no cash flow during the period, so the formula under (e) "Period Return" should just be the investment income divided by the value at the beginning of the period (b/a).

#### IX. Requirement of both time-weighted rate of return and money-weighted rate of return on investments to be calculated and included in RSI

A. It is difficult to get month by month information for some plans. It is often not decision useful to know if this information is dollar-weighted or time-weighted since the difference for single period returns is likely to be insignificant.

#### X. Calculation of blended discount rate

- A. Exemption from performing a calculation and from providing details of a blended discount rate calculation if plan:
  - 1. Is using a closed amortization period, and
  - 2. Can provide history of contributing an actuarially determined amount.

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- B. The projection of assets to depletion date is unnecessary and often impractical for plans receiving contributions according to many actuarially determined funding policies. Such plans should be able to certify to the adequacy of their funding policy without actually doing the asset projection by mathematically demonstrating a closed group proof of sufficiency, such as the following:
  - 1. The funding policy components satisfy the following relationship:

PVFB (benefit payments) = PVFNC + AL = PVFNC + MVA + UAAL + (AVA-MVA),

Where:

PVBF = Present Value of Future Benefit Payments

PVFNC = Present Value of Future Normal Cost

AL = Actuarial Liability

MVA = Market Value of Assets

UAAL = Unfunded Actuarial Accrued Liability = AAL - AVA

AVA = Actuarial value of Assets

2. The funding policy requires payments of all future normal costs (PVFNC) as well as amounts to amortize the current unfunded liability (UAAL) plus (or minus) any deferred losses (or gains) under the asset smoothing method (AVA - MVA).

This proof should only be accepted for closed amortization methods.

In these cases there is no need to calculate a trust depletion date but rather there should be a focus on showing the history of making the full actuarially required contribution.

#### XI. The ASB is an autonomous board.

A. The words "of the American Academy of Actuaries" should be deleted from paragraphs 19. and 50. of GASB ED No. 27 and paragraph 38. from GASB ED No. 25. The ASB (and only the ASB) sets standards for members of the US actuarial professional organizations.

# XII. Reiterate that all the newly required calculations, previously not necessary, will be burdensome and expensive.

- A. Appendix B, Additional Required Services/Work contains a more complete list. However, below are some calculations that the actuary would often be asked to calculate and have no other actuarial purpose other than they are required by the Exposure Drafts. This is not a request but simply an observation.
  - 1. Closed group asset projections to depletion date for the new discount rate calculation
  - 2. Separation of gain/loss into active and retired components
  - 3. Liability weighted average remaining service
  - 4. Time weighted rate of return

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#### I. Actuarial

- A. Projection of long-term contribution effort\*
  - 1. In total
  - 2. Per employer
- B. Projection of payment streams regarding pension benefits of existing covered employees, inactives and retirees
- C. Selection of 30-year tax-exempt municipal bond with appropriate rating
- D. Determination of blended discount rate as of plan valuation date
- E. Calculation of Total Plan Liability (TPL) at resulting disclosure discount rate, if different than what is used for funding purposes, including
  - 1. Long-term expected rate of return and/or,
  - 2. Attribution method
- F. Calculation of TPL at 1.0% increase and 1.0% decrease in the resulting discount rate
- G. Separation of liabilities attributable to active members vs. inactive and retired members regarding
  - 1. Experience gains and/or losses, and
  - 2. Impact of any assumption changes
- H. Calculation of the collective
  - 1. Net Pension Liability
  - 2. Deferred outflows of resources related to pensions and deferred inflows of resources related to pensions
  - 3. Pension Expense (including amortizations on items listed in G. above and expected vs. actual earnings on plan investments)
- I. Roll-forwards\* to various employer year-end dates, regarding
  - 1. TPL, and
  - 2. Plan Net Position (if eventually determined roll-forwards are allowable regarding estimated year-end asset values)
- J. Calculation of each employer's "proportion"\*

<sup>\*</sup> Items required specifically for multiple employer cost-sharing plans/employers or other types of plans required to report as if a cost-sharing plan/employer.

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### II. Accounting/Auditing

- A. Valuation of assets at all possible affiliated employers' year-end dates\* (specific complications regarding hedge funds, private equity and real estate asset categories)
- B. Possible formal audit at all possible affiliated employers' year-end dates\*
- C. Calculation of both time-weighted and money-weighted rates of return

#### III. Cost-Sharing Plan Administrative Staff\*

- A. Dissemination of collective (plan level)
  - 1. Disclosure amounts including collective Pension Expense
  - 2. Proportionate shares
  - 3. Detailed Note Disclosures
- B. Possible addition to staff in order to
  - 1. Complete asset valuations and/or accounting requirements in a timely fashion, and
  - 2. Assist with dissemination of necessary information to affiliated employers (and possible governmental non-employer contributing entities)

#### IV. Affiliated Employer Staff

- A. Recognition of Net Pension Liability on financial statements
- B. Development (and tracking) of Pension Expense
- C. Complicated Note Disclosures
- D. Detailed Benefit Descriptions
- E. 10-year schedules at collective plan\* level <u>and</u> employer level
- F. Possible addition to staff in order to complete accounting requirements in a timely fashion

<sup>\*</sup> Items required specifically for multiple employer cost-sharing plans/employers or other types of plans required to report as if a cost-sharing plan/employer.

## Appendix C, Simplified Solution to Multiple Employer Reporting Issues

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Below is a brief proposal of a simplified solution – regarding cost-sharing employers and employers that are required to report as if a cost-sharing employer.

- I. Mandate that all pertinent applications of assumptions and calculations are to be completed by the plan (not employer)
- II. Require collective Pension Expense to be included in note disclosures (audited section of financials)
  - A. Exclude employer-only Pension Expense items (as discussed in response letter) from final requirements
- III. To save on cost associated with financial and accounting disclosures and to promote timeliness of those disclosures, when employer year-end does not align with plan year-end, allow plan disclosure to be used without re-valuations (or roll-forwards) of assets and liabilities, if
  - A. Employer year-end is within 12 months of plan year-end
  - B. No significant events have occurred from plan year-end to employer year-end
- IV. Employer's proportionate share
  - A. Require plan to calculate and provide to all employers, each employer's proportionate share based on expected long-term contribution effort, OR
  - B. Simplify further and base proportionate share on information to which the employer already has access and can determine without plan input (i.e., prior or current year's payroll, prior or current year's contribution, etc.)
- V. Once plan disclosures are finalized and employer's proportionate share is determined, all necessary information would be available to employer for purposes of compiling necessary disclosures
- VI. Allow employers to reference plan disclosures regarding note disclosures and benefit/investment summaries, rather than re-printing them in employer year-end reports
- VII. Although perhaps a little less detailed than currently proposed, if suggested elements were adopted, multiple employer complexity issues would be resolved, while achieving all stated goals and objectives of the GASB:
  - A. Improve accounting and financial reporting,
  - B. Provide decision-useful information,
  - C. Support assessments of accountability and interperiod equity, and
  - D. Create improved additional transparency, while greatly reducing unnecessary complexities.