6 Buckingham Drive Princeton, NJ 08540 October 14, 2011

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

Re: Project No. 34-E - Exposure Draft on Pension Accounting and Financial Reporting by Employers

Dear Sirs:

Thank you for the opportunity to comment on Governmental Accounting Standards Board ("GASB") Project No. 34-E (i.e., Exposure Draft on Pension Accounting and Financial Reporting by Employers).

NOTE: The comments provided herein are my own and not those of the New York City Retirement Systems or the City of New York for whom I work.

Comments

In its Preliminary Views on this topic, GASB proposed for pension accounting and financial reporting a Level Cost concept model using traditional actuarial assumptions.

In my letter of September 16, 2010 (a copy of that letter [with the original typos] is attached), I suggested that GASB reconsider its choice of the Level Cost concept and replace it with a benefit accrual model, valued on an economic basis. That letter discussed in detail the issues and the reasoning.

This suggestion was not followed and the Exposure Draft largely repeats the concepts set forth in Preliminary Views.

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I therefore respectfully repeat my suggestion, even at this late date, that GASB restart this entire project and develop its proposed pension accounting and financial reporting rules to be based on a benefit accrual model using assumptions consistent with an economic basis of valuation.

Assuming that this suggestion is not followed, I then respectfully request that GASB review with great care and in great detail the costs to Public Plans and Plan Sponsors to implement the proposed new rules.

In Closing

Thank you again for the opportunity to comment.

If you have any questions, please let me know.

Yours truly,

Robert C.

Digitally signed by Robert C. North, Jr.

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Robert C. North, Jr., F.S.A, F.C.A, F.S.P.A, M.A.A.A, E.A.

Att:

Additional Response to GASB Preliminary Views

Robert C. North, Jr. September 16, 2010

Again, thank you for an opportunity to comment on GASB Preliminary Views ("PV") on Pension Accounting and Financial Reporting by Employers.

The remarks herein are my own and do not represent those of the New York City Retirement Systems or the City of New York for whom I work.

Following are some overview comments. Thereafter are responses to the specific issues on which GASB requested input.

General Comments

This writer believes that GASB would provide more appropriate accounting and financial reporting for Public Pension Plans if it followed a benefit accrual model with values established using economics-basedprinciples.

The PV acknowledges that expensing can differ from funding. That said, the PV then chooses to continue following most of the concepts, based on traditional actuarial assumptions and methods that are used for funding.

The PV does propose to decrease the range of existing practice that is acceptable under GASB25 and GASB27. For example, the PV would limit the choice of Actuarial Cost Method ("ACM") to the Entry Age ACM. The PV would also reduce, for many Public Pension Plans, the amortization periods for expensing any Unfunded Actuarial Liabilities ("UAL"). Nevertheless, the PV proposes to continue the use of funding (i.e., budgeting) methodologies to drive expensing (i.e., accounting) rules.

Going to first principles, the pay and benefit expenses of most employees increase with age and service.

The economic value of pension benefits increase with age and service, both in dollars and as a percentage of payroll.

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Using a Level Cost concept, implemented with traditional actuarial budgeting techniques, does not comparably reflect the value of pension benefits. The PV explicitly rejects determining the value of benefits earned to date. The PV also explicitly rejects determining of the economic value of those benefits.

To this writer, these decisions seem inconsistent with the accounting and financial reporting for other types of compensation, as well as inconsistent with the Concept Statements set forth by GASB itself.

Responses to the GASB PV Questions

<u>Issue 1 - An Employer's Obligation to Its Employees for Defined</u> Pension Benefits

Question 1: It is the Board's preliminary view that, for accounting and financial reporting purposes, an employer is primarily responsible for the portion of the obligation for defined pension benefits in excess of the plan net assets available for benefits. Do you agree with this view? Why or why not?

Ultimately, an employer is responsible for ALL of the benefits it promises. The value of those benefits may be funded and mitigated through assets held in trust, but the employer is not just responsible for the value of benefits in excess of plan net assets available for benefits.

Recognizing the value of all benefits, with recognition of any supporting assets, would seem more appropriate.

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Additional Response to GASB Preliminary Views

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<u>Issue 2 - Liability Recognition by a Sole or Agent Employer</u>

Question 2a. It is the Board's preliminary view that the unfunded portion of a sole or agent employer's pension obligation to its employees meets the definition of a liability (referred to as an employer's net pension liability). Do you agree with this view? Why or why not?

I disagree on the specifics of the question as asked but do agree that the economic value of benefits accrued to date would meet the definition of a liability. Also, see answer to Question 1.

Question 2b. It is the Board's preliminary view that the net pension liability is measurable with sufficient reliability to be recognized in the employer's basic financial statements. Do you agree with this view? Why or why not?

I disagree on the specifics of the question as asked but do agree that the economic value of benefits accrued to date is measureable with sufficient reliability to be recognized in the employer's basic financial statements. Also, see answer to Question 1.

In addition, since the Market Value of Assets already exists on the Balance Sheet, having a Market Value of Liabilities ("MVL") (referred to earlier as an economic value of benefits accrued to date) would be the only truly consistent approach.

I do not accept the argument that MVL versus MVA is inconsistent with the long-term nature of Public Pension Plans.

Nor does MVL versus MVA necessarily need create unreasonable volatility in accounting statements to the extent that the accounting recognizes the service costs, interest costs and legacy costs in some reasonable manner.

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Of course, to the extent the Plan being reported upon has a significant mismatch between the characteristics of its assets and its liabilities and has chosen not to hedge this mismatch, then volatility exists in the real world, and it may be appropriate to report this.

<u>Issue 3 - Measurement of the Total Pension Liability Component of the Net Pension Liability by a Sole or Agent Employer</u>

Question 3a. It is the Board's preliminary view that the projection of pension benefit payments for purposes of calculating the total pension liability and the service-cost component of pension expense should include the projected effects of the following when relevant to the amounts of benefit payments: (1) automatic cost-of-living adjustments (COLAs), (2) future ad hoc COLAs in circumstances in which such COLAs are not substantively different from automatic COLAs, (3) future salary increases, and (4) future service credits. Do you agree with this view? Why or why not?

I agree that the portion of Item #1 accrued to the date of measurement should be included, along with the accrued value of any other benefits whose payment is expected by law or contract.

I disagree with recognition of Items #3 and #4 as these represent are clearly events attributable to future measurement periods.

With respect to Item #2, to the extent the Plan Sponsor maintains discretion over the decision on whether or not to grant an ad hoc COLA, the obligation should not be recognized until the actual event. This is how cash compensation, including cash bonuses, is handled and as pensions are a form of deferred compensation, this writer believes a similar treatment is appropriate.

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Question 3b. What criteria, if any, do you suggest as a potential basis for determining whether ad hoc COLAs are not substantively different from an automatic COLA and, accordingly, should be included in the projection of pension benefit payments for accounting purposes?

I believe that the determination of whether an ad hoc COLA is substantially different from an automatic COLA can be anticipated by looking at the process used and frequency of granting the COLAs. However, even if ad hoc COLAs are granted with sufficient frequency as to appear almost automatic, if the Plan Sponsor retains discretion, then they should not be recognized until granted.

3c. It is the Board's preliminary view that the discount rate for accounting and financial reporting purposes should be a single rate that produces a present value of total projected benefit payments equivalent to that obtained by discounting projected benefit payments using (1) the long-term expected rate of return on plan investments to the extent that current and expected future plan net assets available for pension benefits are projected to be sufficient to make benefit payments and (2) a high-quality municipal bond index rate for those payments that are projected to be made beyond the point at which plan net assets available for pension benefits are projected to be fully depleted. Do you agree with this view? Why or why not?

I disagree. The economic value of benefits most appropriate for comparison with the MVA is the MVL, calculated based on benefits accrued to date and discounting using yields on fixed income securities whose likelihood of payment is similar the likelihood of the benefit payments. For most Public Pension Plans where there are supporting assets and Constitutional Protections against diminishment, payment of the benefits is nearly certain and U.S. Treasury Securities are the most comparable assets. Also, see answer to Question 2b.

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Question 3d. It is the Board's preliminary view that for purposes of determining the total pension liability of a sole or agent employer, as well as the service-cost component of pension expense, the present value of projected benefit payments should be attributed to financial reporting periods over each employee's projected service life using a single method—the entry age actuarial cost method applied on a level-percentage-of-payroll basis. Do you agree with this view? Why or why not?

I disagree with this Level Cost approach. Benefits do not accrue on a Level Cost basis.

<u>Issue 4 - Attribution of Changes in the Net Pension Liability to</u> Financial Reporting Periods by a Sole or Agent Employer

Question 4a. It is the Board's preliminary view that the effects on the net pension liability of changes in the total pension liability resulting from (1) differences between expected and actual experience with regard to economic and demographic factors affecting measurement, (2) changes of assumptions regarding the future behavior of those factors, and (3) changes of plan terms affecting measurement should be recognized as components of pension expense over weighted-average periods representative of the expected remaining service lives of individual employees, considering separately (a) the aggregate effect on the liabilities of active employees to which the change applies and (b) the aggregate effect on the liabilities of inactive employees. Do you agree with this view? Why or why not?

In general, I agree.

Additional Response to GASB Preliminary Views

Robert C. North, Jr. September 16, 2010

Question 4b. It is the Board's preliminary view that the effects on the net pension liability of projected earnings on plan investments, calculated using the long-term expected rate of return, should be included in the determination of pension expense in the period in which the earnings are projected to occur. Earnings on plan investments below or above the projected earnings should be reported as deferred outflows (inflows) unless cumulative net deferred outflows (inflows) resulting from such differences are more than 15 percent of the fair value of plan investments, in which case the amount of cumulative deferred outflows (inflows) that is greater than 15 percent of plan investments should be recognized as an increase or decrease in expense immediately. Do you agree with this view? Why or why not?

I disagree with the use of expected returns based on actuarial assumptions. I disagree with smoothing and/or corridors for recognizing MVA. See answers to Questions 1, 2a, 2b and 3c.

<u>Issue 5 - Recognition by a Cost-Sharing Employer</u>

Question 5a. It is the Board's preliminary view that each employer in a cost-sharing plan is implicitly primarily responsible for (and should recognize as its net pension liability) its proportionate share of the collective unfunded pension obligation, as well as its proportionate share of the effects of changes in the collective unfunded pension obligation. Do you agree with this view? Why or why not?

I agree with the concept but note the possible significant cost and challenge of producing reasonably useful information.

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Question 5b. The Board is considering basing the determination of proportionate shares of the collective net pension obligation on employers' respective shares of the total annual contractually required contributions to the plan and believes that would provide a reliable basis for measurement. However, the Board is seeking constituent input regarding other potential bases that might exist for this determination. What basis, if any, do you suggest for determining a cost-sharing employer's proportionate share of the collective net pension obligation?

The only proper determination would be to calculate the obligation for each employer based on its employees. It should be noted, however, that this may be impractical where cost-sharing PERS do not retain information on the prior employers of retirees. Further, this does not address the issue of how to allocate assets in a cost-sharing PERS.

Issue 6 - Frequency and Timing of Measurements

Question 6. The Board's preliminary view is that a comprehensive measurement (an actuarial valuation for accounting and financial reporting purposes) should be made at least biennially, as of a date not more than 24 months prior to an employer's fiscal yearend. If the comprehensive measurement is not made as of the employer's fiscal year-end, the most recent comprehensive measurement should be updated to that date. Professional judgment should be applied to determine the procedures necessary to reflect the effects of significant changes from the most recent comprehensive measurement date to the employer's fiscal year-end. Determination of the procedures needed in the particular facts and circumstances should include consideration of whether a new comprehensive measurement should be made. Do you agree with this view? Why or why not?

I agree with the concept that MVL should be determined as of the same date as MVA is measured. However, given the almost universal need to roll forward MVL from earlier periods, the cost and complexity may be significant.

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