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October 13, 2011

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

**Re: Project No. 34-E — Exposure Draft, *Accounting and Financial Reporting for Pensions*
Project No. 34-P — Exposure Draft, *Financial Reporting for Pension Plans***

Dear Mr. Bean:

Deloitte & Touche LLP is pleased to comment on the GASB's Exposure Drafts, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27* (the "Employer ED") and *Financial Reporting for Pension Plans — an amendment of FASB Statement No. 25* (the "Plan ED") (collectively, the "EDs").

We support the Board's efforts to improve the pension accounting and reporting standards for state and local governmental employers and pension plans. We specifically support the recognition of the net pension liability of an employer's defined benefit pension plans in the financial statements and the measurement of those plans' assets and total pension liabilities as of the date of the employer's fiscal year-end statement of financial position.

However, we have concerns about whether the proposed amendments to an employer's accounting for its participation in a cost-sharing multiple-employer pension plan may present operational challenges. Therefore, we suggest that before it finalizes the amendments and determines transition and implementation timing, the Board consider feedback from financial statement preparers and multiple-employer plan administrators, auditors, and other interested parties on the operational challenges of the proposed guidance.

The attached appendix contains our comments on the proposals. Unless it is clear from context or we have noted otherwise, our comments apply to both EDs.

Deloitte & Touche LLP appreciates the opportunity to comment on the EDs. If you have any questions concerning our comments, please contact Karen Wiltsie at (203) 761-3607.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl
W. Michael Fritz

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Appendix Deloitte & Touche LLP

Recognition of the Net Pension Liability in Government Employer Financial Statements (Employer ED)

We agree that requiring recognition of the net pension liability in an employer's financial statements is an improvement to financial reporting because it provides greater transparency in an employer's financial reporting for its defined benefit plan obligations and allows users to better assess a government's accountability and interperiod equity.

We believe that an employer is primarily responsible to its employees for the unfunded portion of a defined benefit pension obligation. We agree that such obligation by the employer is consistent with the "employment exchange" discussed in paragraph 127 of Appendix B of the Employer ED.

We agree that the unfunded portion of an employer's pension benefit obligation to its employees represents a present, constructive obligation of the entity. This view is consistent with Concepts Statement 4,¹ which defines liabilities as "present obligations to sacrifice resources that the government has little or no discretion to avoid." Further, paragraph 19 of Concepts Statement 4 notes that an example of a constructive liability incurred by the government is an obligation incurred with respect to services provided by an employee, including services the employee provides with an expectation of deferred compensation, such as a pension.

Measurement of the Total Pension Liability

Projection of Benefits

We agree that the measurement of the employer's present obligation should reflect the expected effects of future events on the ultimate payment of benefits to the employee because the impact of those future events represents actual or implied contractual or "substantive" commitments to the employees for services provided. Employers should take these effects into account when measuring the service costs of the individual periods of employment that comprise an employee's expected career. We believe that future service credits should be reflected in an employer's determination of both the amount of and eligibility for prospective pension benefits in a manner similar to the assumptions an actuary uses in determining continuation of employment.

We also agree that ad hoc cost of living adjustments (COLAs) and other postemployment benefit changes (as defined in the EDs' glossaries) should be included in benefit projections if there are indications they effectively have become automatic. This approach is consistent with the concept of accounting for the "substantive plan"; that is, the plan as understood by the employer and plan members. We believe that the principles-based considerations described in the EDs' relevant footnotes are reasonable. Those considerations include "the historical pattern of granting changes and the consistency in the amounts of the changes." However, we also believe that a pattern does not necessarily have to mean a long history of adjustments. Although an initial adjustment may be considered ad hoc, even a second adjustment of the same or similar nature could be considered a pattern that would result in the COLA's no longer being considered ad hoc. Accordingly, the footnotes

¹ GASB Concepts Statement No. 4, *Elements of Financial Statements*.

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should also indicate that there may be evidence demonstrating that changes might be expected to continue to be granted even in the absence of a long history of adjustments.

We also agree that the actuarial accrued liability as of the measurement date should include only costs assigned to the period preceding the measurement date.

Discounting Projected Benefit Payments

We disagree with the use of a discount rate that reflects the long-term expected rate of return on plan investments in the manner described in the EDs. We understand that the GASB selected the long-term expected rate of return on current and future plan investments as the appropriate discount rate largely because of “the integrated nature of the promise to pay pensions and the accumulation of assets dedicated to the payment of those benefits in a pension plan,” as stated in paragraph 191 of the Employer ED. However, we prefer the “alternative view” presented in paragraphs 287–290 of the Employer ED, stating that the employer’s pension liability should be determined by using a discount rate that is unrelated to the employer’s funding approach. As noted in paragraph 288 of the Employer ED, “[o]ther liabilities are not measured based on the anticipated prospect of earnings from the sources from which they are expected to be paid.” Similarly, an employer is obligated to pay pension benefits regardless of whether the related pension investments earn a particular rate of return. Accordingly, we believe the pension liability is best measured by using a settlement rate approach to discounting; that is, by using the expected long-term rate of return on a portfolio of high-quality fixed-income investments that would provide sufficient cash flows to settle the obligations of the pension plan when due.

Further, determining the discount rate on the basis of the long-term expected rate of return on plan assets is highly subjective because it requires assumptions about the timing and amount of future contributions, expected future rates of return, and future allocation of plan investments among asset classes. In particular, future contributions are usually fully within the control of the employer, so regardless of the employer’s present intent, it may not be possible to determine the reliability of this assumption. Auditors of pension plans and government-employer financial statements may find these assumptions to be difficult to audit because of their subjectivity. Use of a settlement rate that is based on observable market data about yields on high-quality bonds is more objective and will also permit greater comparability among entities.

Using a long-term expected rate of return as the discount rate also could result in unintended consequences. For example, an assumption of a higher-risk investment approach (asset mix) will result in a higher discount rate and therefore a smaller pension liability, whereas a rate reflecting a less aggressive investment approach (i.e., lower discount rate) would result in a larger pension liability.

If the Board does not accept the alternative view, we urge that the long-term expected rate of return on plan investments be used to determine the discount rate only to the extent that plan net position already exists as of the reporting date. We believe it is inappropriate for an employer to make assumptions about the availability of plan assets resulting from future contributions to the plan and the long-term investment of those future contributions because, as discussed above, the future intent and ability of the employer to make such contributions over the long term is subjective and may be highly uncertain.

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Attribution Method

We agree with the GASB's decision to require a single actuarial method for the accounting and reporting of an employer's total pension liability because we believe it promotes comparability with other governmental entities. The required use of a single method over time also promotes consistency in financial reporting.

However, we continue to believe that the projected unit credit actuarial cost method best reflects measurement of the total pension liability and the attribution of costs to periods of employee service on the basis of the pension benefits earned by the employee in those periods. We acknowledge that, on the basis of GASB staff research, the majority of employers currently use the entry age normal actuarial method to attribute pension benefits. Therefore, for many employers, use of the entry age normal method will be consistent with use of that actuarial method in determining funding requirements. However, we believe that the actuarial method used should result in the attribution to periods of employee service on the basis of the plan's benefit formula for accrual of such benefits. The projected unit credit method is consistent with the liability that the employer has actually incurred as a result of providing employee services in the periods preceding the date of the financial statements.

We acknowledge that given the long-term nature of pension plans, the entry age normal actuarial cost method has some merit with regard to achieving interperiod equity because it results in substantially all the cost of the pension benefit being accrued in a systematic and rational manner over the period the employee provides services. We believe that the entry age normal method, while not our preferred approach, would be an acceptable alternative to the projected unit credit method.

Measurement of Pension Expense

Recognition of Experience Differences and Changes in Assumptions

Conceptually, we believe that the most supportable approach is recognition in current-period pension expense of the effects of transactions and other events that affect the pension benefit obligations as they occur each year. Any deferred recognition represents a smoothing mechanism that is not based on the reporting principles outlined in paragraphs 25–27 of Concepts Statement 4.

Accordingly, we support the immediate recognition in pension expense of (1) the effect on the total pension liability of changes in benefit terms and (2) the effect of differences between expected and actual experience and changes in assumptions to the extent that they relate to total pension liabilities to inactive employees.

We agree that although it is not conceptually ideal, a significant improvement over existing accounting standards would result from the GASB's proposal to require recognition of the effect of differences between expected and actual experience with regard to economic or demographic factors and changes in assumptions, to the extent that they relate to active employees, in pension expense over a closed period representative of the average expected remaining service life of those active employees. However, we recommend that the GASB provide guidance on how to allocate the effect of experience differences and changes in assumptions between active and inactive participant groups.

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Effect of Differences Between Return on Plan Investments and Actual Experience

While we believe that recognizing differences between planned and actual earnings on plan investments in the period in which they occur is conceptually more appropriate, a five-year period is a significantly shorter period than the period over which such differences typically would have been recognized in pension expense under existing standards and is a significant step in the right direction. We also understand that use of a relatively short, closed amortization period such as five years is considered an acceptable practice under the actuarial standards.² Since these fluctuations are not considered to be under the control of the employer, the delayed recognition reduces period-to-period volatility while still largely achieving interperiod equity. Accordingly, we do not object to the GASB's proposed approach.

Cost-Sharing Multiple-Employer Plans (Employer ED)

We agree that each employer in a cost-sharing plan is implicitly responsible for its net pension liability and the effects of the net changes therein. However, we have several concerns about the potential operational challenges associated with the ED's approach to determining each employer's proportionate share of the collective net pension liability and related amounts.

In particular, we question the practicality of the proposed use of the "measure of the employer's projected long-term contribution effort to the pension plan as compared to the total of all projected contributions of the employers" to determine each employer's proportionate share of the net pension liability. A multiple-employer plan's management will need to make potentially highly subjective assumptions covering many future years about future contribution rates and each participating employer's ability to make the required contributions. Auditing such assumptions may be challenging. We recommend that the GASB consider approaches to determining each employer's proportionate share (1) that would be more objective and practical to apply and (2) for which sufficient audit evidence is more likely to exist.

Also, the plan's financial information that is provided to each participating employer and used to prepare the employer's financial statements and related note disclosures will need to be audited to the extent that the employer's proportionate share of the related balances is material to the employer's financial statements. However, the plan financial statements and disclosures prepared in accordance with Statement 25³ and the Plan ED would not provide each participating employer with information about such proportionate share of the net pension liability and related amounts (e.g., total pension liability, plan net position, pension expense for the period). We therefore recommend that the Board consider requiring that information about each employer's proportionate share be included as part of the plan financial statements so that the information is appropriately covered by the audit of the plan.

Since it would not be practical for the auditor of each participating employer to audit the collective plan information and the employer's proportionate share, the plan's auditor most likely will need to act as a component auditor on which the employer's auditor relies. Under the AICPA's clarified auditing standards (effective for periods ending on or after December 15, 2012), the group auditor (i.e., the employer's auditor) will need to obtain an understanding of the component auditor and the work it

² Actuarial Standard of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, notes that "any differences between the actuarial value of assets and the market value are recognized within a reasonable period of time," and "recognizes differences from market value in a sufficiently short period."

³ GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*.

performs if the “component” is considered significant to the employer’s financial statements. For plans with a significant number of participating employers, it may not be practical for the plan’s auditor to interact with each employer’s auditor in the manner intended by the AICPA auditing standards.

A cost-sharing employer’s accounting for its proportionate share of the net pension liability as of the end of the employer’s reporting period may result in the need for the plan administrator to determine the collective total pension liability and plan net position as of several dates in each annual cycle if participating employers have year-ends that differ from the plan’s year-end. Although the collective total pension liability determined as of the actuarial valuation date could most likely be rolled forward relatively easily, in the calculation of net pension liability, the fair values of plan assets will need to be determined as of those multiple dates so that each employer’s proportion of plan net position can be assessed. While this determination may be practical for assets with readily-available market prices, it may be complex, time-consuming, and costly for alternative investments. Further, if participating employers have multiple year-ends that differ from the plan’s year-end, audits of the plan’s financial statements (or audit procedures performed by the plan’s auditor and communicated to the auditors of the applicable participating employers) could be required as of and for several different dates and periods in an annual cycle.

We suggest that the GASB consider the feedback it receives from preparers (both employers and plans), actuarial communities, and others regarding the potential operational challenges associated with an employer’s measuring and recognizing its obligation and expense for its participation in a cost-sharing multiple-employer plan as of the end of the employer’s reporting period.

Agent Multiple-Employer Plans

An agent employer’s accounting for its net pension liability as of the end of its reporting period may result in the need for the agent multiple-employer plan to determine the plan net position as of several dates in each annual cycle if participating employers have year-ends that differ from the plan’s year-end. As discussed above with regard to cost-sharing multiple-employer plans, plan administrators will need to determine the fair values of plan assets as of those multiple dates to assess the employer’s share of plan net position.

The plan financial statements and disclosures prepared in accordance with Statement 25 and the Plan ED for an agent multiple-employer plan would not provide each participating employer with information about its share of the plan net position. We recommend that the Board consider requiring that information about each employer’s share of plan net position be included as part of the plan financial statements so the information is appropriately covered by the audit of the plan.

Further, if participating employers have multiple year-ends that differ from the plan’s year-end, the requirement for an employer to account for its participation in an agent multiple-employer plan as of the end of its reporting period could result in audits of the plan’s financial statements as of and for several different dates and periods in an annual cycle.

We suggest that the GASB consider the feedback it receives from preparers (both employers and plans), actuarial communities, and others regarding the potential operational challenges associated with an employer’s measuring and recognizing its obligation and expense for its participation in an agent multiple-employer plan as of the end of the employer’s reporting period.

Note Disclosures and Required Supplementary Information (Employer ED)

We agree with the newly proposed disclosure requirements outlined in the ED. However, we believe that if the employer has not made some or all of the actuarially required contributions in current or recent prior years, the employer should prominently disclose this fact in the notes to the financial statements and should also disclose the actuarially calculated employer contributions and related amount of actual contributions made as well as a discussion of any significant related risks and uncertainties. This is particularly important if a government is experiencing financial difficulties or other constraints in making its actuarially-determined pension contributions or if the ratio of plan net position to the total pension liability is low or decreasing rapidly. Even though such information may already be included in the supplementary information required by paragraph 42c of the ED, we believe that this note disclosure would enhance the employer's ability to meet the Board's objectives of improving transparency and providing decision-useful information to users.

Special Funding Situations (Employer ED)

We agree with the Board's continuation of the approach required by Statement 27⁴ for special funding situations. We also support the newly proposed requirements in the ED for the nonemployer government. We believe that in an unconditional special funding situation, the nonemployer government has a constructive liability to contribute to the pension plan. Therefore, we agree that it must recognize its proportionate share of the net pension liability, deferred inflows and outflows of resources, and pension expense. The additional disclosures required by the ED would allow users of the financial statements to better understand the difference between the government's obligations to fund defined benefit plans for its own employees relative to its obligation to fund plans for employees of other governments.

However, we do not agree that the employer's financial statements should reflect a net pension liability, and deferred outflows of resources and deferred inflows of resources related to pensions, that are net of the nonemployer government's proportional share resulting from an unconditional funding obligation. Since a central premise of the ED is that the pension liability arises from the exchange transaction between employer and employee, we believe that the employer's financial statements should present the entire net pension liability and related amounts. The nonemployer's contribution should be treated as a nonexchange transaction between the two governments in a manner consistent with the principles of Statement 33.⁵ If criteria consistent with those in Statement 33 are met, the employer should be permitted to record a receivable for the nonemployer government's proportionate share. This approach is consistent with the requirement to present the entire pension cost as an expense/expenditure in the employer's financial statements, with revenue recognized for the proportion being funded by the nonemployer government.

Defined Contribution Plans

We agree with the Board's continuation of the current approach for financial accounting and reporting for defined contribution plans under existing GASB standards. In addition, the guidance in the EDs is helpful in (1) clarifying that the required expense/expenditure is the amount defined by the plan's terms as being attributable to employee services provided during the period and (2) addressing accounting for forfeitures.

⁴ GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*.

⁵ GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

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Effective Date and Transition

Given the challenges that employers and plans would face in complying with the new financial reporting and disclosure requirements under the EDs, we believe that for all plans and employers, the final standards should reflect a single effective date of no earlier than periods beginning after a date that is at least one year after the issuance of the final standards. The amount of a plan's net position is not necessarily an indicator that the employer has the resources to adopt more quickly than other governments. We agree that earlier application should be encouraged.