



October 17, 2011

Mr. David R. Bean
Director of Research and Technical Activities
Project No. E-34
Governmental Accounting Standards Board
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Via electronic mail to: director@gasb.org

RE: GASB Plain-Language Supplement – Pension Accounting and Financial Reporting

Dear David:

The National Federation of Municipal Analysts (NFMA) welcomes this opportunity to comment on GASB's *Plain-Language Supplement for Pension Accounting and Financial Reporting*.

NFMA was chartered in 1983 as a not-for-profit association with the goals of promoting professionalism in municipal credit analysis and furthering the skill level of our members. We do this through educational programs and industry communication, providing an informed perspective on legal and regulatory matters relating to the municipal finance industry, and by facilitating the flow of information between investors and issuing entities.

NFMA membership includes approximately 1,000 members who evaluate credit and other risks of municipal securities. Members represent institutional investors, insurance companies, broker/dealers, bond insurers, and rating agencies. Credit analysts are present at all stages of a municipal securities transaction, from its inception to its structuring, insuring, and rating, to its sale and resale in the primary and secondary markets. While each analyst's company may have a different role in the marketplace, understanding and communicating credit risk is the analyst's unifying link. As primary users of financial and operational information provided by municipal and other issuers, the NFMA typically supports measures that improve the quality and timeliness of that information.

To this end, and as users of governmental financial information, we are providing comments on the above-referenced document. Our responses to the questions in the Plain-Language Supplement are presented below.

Before we present these responses, the NFMA would like to make two additional comments. First, as users of governmental accounting statements, the NFMA encourages and is supportive of GASB's efforts to enhance transparency in reporting and to illuminate in greater detail the methods and data to be presented by governmental entities in their accounting statements. Such data are useful to credit analysts as we prepare, rate, review, purchase, monitor, and sell municipal bond offerings. Second, when the final guidelines are prepared, we advocate that pension-related financial data be located in a single, easy to locate position within the final audit. Pension information will be much more usable if presented in a clear and concise manner, in a tabular format when appropriate, and at an easily identifiable location within the financial report. The availability of this comprehensive disclosure will allow for consistent comparisons across governmental entities.

Questions 1 and 2: Recognizing the Net Pension Liability

1. Do you agree or disagree with GASB's proposal that governments recognize the net pension liability in their financial statements? Why do you agree or disagree?

The NFMA agrees with GASB's proposal to include the net pension liability in financial statements and with the concept that the government or employer that provides benefits is responsible for and should report this liability. Pension obligations clearly fit GASB's definition of a liability as a "present obligation to sacrifice resources that the government has little or no discretion to avoid". The lack of disclosure of pension obligations in financial statements has led to confusion among municipal market participants and the public.

2. How would this proposal affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?

Including the net pension liability in an issuer's financial statements would be useful in that it would assist in analysis of an issuer's financial health. The fact that the liability has not been included in financial statements, other than in the notes, results in a significant omission to issuer balance sheets. Recognizing the magnitude of this liability, which is met over an extended period of time, would allow more accurate assessment of interperiod equity.

Questions 3 and 4: Measuring the Total Pension Liability

3. Do you agree or disagree with GASB's proposals for how the total pension liability should be measured? Why do you agree or disagree?

4. How would those proposals affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?

We agree in general with GASB's proposals for how the total pension liability should be measured. In particular, we make the following comments on GASB's "Summary of Proposals" in this section of the Plain-Language Supplement:

- *All assumptions used in projecting benefit payments would conform to Actuarial Standards of Practice, unless otherwise stated by the GASB.*

We agree with this proposal, as it will ensure adherence to one set of standards and should help to make pension disclosure more comparable.

- *Future salary increases and future periods of employment with the government would continue to be incorporated into projections of benefit payments.*
- *Automatic COLAs and other automatic postemployment benefit changes would continue to be incorporated into projections of benefit payments, and ad hoc COLAs and other ad hoc postemployment benefit changes would be included as well if an employer's practice indicates that they are essentially automatic.*

These two proposals will help capture the future economic effects of current policy decisions and are therefore supported by NFMA.

- *The discount rate would combine (1) the long-term expected rate of return on plan investments as long as the pension plan is projected to have assets to make projected benefit payments for current employees, retirees, and their beneficiaries, and (2) a tax-exempt, high-quality municipal bond index rate beyond that point.*

NFMA does not have an opinion on the suitability of a given discount rate. We do however have concerns that a "blended" rate as described above would detract from the goals of comparability and transparency.

In light of our concerns about the blended rate and the different views on the most suitable discount rate, we recommend that duration of the pension liabilities be disclosed in notes to the financial statements (for any given discount rate, duration is defined as the weighted average of the years until the pension payments come due, and where the weights are the proportion that each year's payments represent of the total liability). Adding this information would enhance transparency and allow analysts to make adjustments to the information presented in the financial statements.

- *Projected benefit payments would be discounted to each employee's entry age and attributed over the employee's expected term of service as a level percentage of payroll.*

NFMA agrees with the goal of having issuers use a single method of allocating present value, i.e. entry age normal, and doing so as a level percentage of payroll. These methods reflect the ongoing and annual exchange of service for benefits over the course of an employee's period of employment in amounts that keep pace with the employee's projected salary over that period.

The information provided by implementation of these proposals would make pension data more useful to our members and would better enable us to assess a government's accountability. Because the information addresses obligations that must be provided for over a number of decades, it would also make us more able to assess interperiod equity.

As a final note, and regarding the measurement of Total Pension Liability, it would be valuable for analysts to see the "before" and "after" impact of the revised standards, but most specifically the effect of changes in discount rates. This would be useful for at least the first year, so that the relative impact and difference in liabilities of the proposed rate change can be seen.

Questions 5 and 6: Measuring Pension Expense

5. Do you agree or disagree with GASB's proposals regarding when the factors that affect pension expense should be incorporated into the expense calculation? Why do you agree or disagree?

6. How would those proposals affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?

Of the main components of municipal pension expense, NFMA responds as follows:

- 1) Regarding the treatment of current year service benefit expenses, interest on the issuer's total pension liability, and changes in the municipality's total pension liability: NFMA agrees with GASB that such items should be treated as a pension expense recognized in the current year at 100%. We also recommend that these amounts be separately footnoted.
- 2) Regarding the current year expense recognition of actual economic/demographic data for inactive employees and retirees, NFMA agrees with GASB that such items should be recognized as a pension expense in the current year item and also recommends that these amounts be separately footnoted. NFMA also agrees with GASB that recognition of these expenses for active employees should be treated as a deferred outflow/inflow of resources. However, NFMA is concerned about GASB's proposal to recognize these deferred amounts over a weighted average of the expected remaining aggregate service life of the active employees, as this deferral period would vary from year to year and would therefore make year-to-year comparisons of pension expense more difficult. NFMA believes any recognition period should be closed and used consistently in subsequent periods.

- 3) Regarding the changes in the municipality's total pension plan assets, NFMA agrees with GASB that changes in projected pension plan investment earnings should be recognized as a pension expense in the current year at 100% and recommends that these amounts be separately footnoted. Regarding current expense recognition for non-investment earnings changes in plan assets, NFMA agrees with GASB that such changes should be recognized as a pension expense in the current year at 100% and recommends that the amount be separately footnoted. Regarding recognition of actual pension investment earnings, NFMA disagrees with the GASB proposal that such amounts should be treated as a deferred outflow/inflow of resources recognized over five years. NFMA recommends that this amount be recognized as a current year expense item and that this amount be separately footnoted. NFMA believes that GASB's proposed treatment of pension investment earnings will mask the true effects of any realized increases/decreases in plan investment earnings on the issuer's near-term liquidity and on its ability to fund annual pension expenses from cash flow.

Beyond the specific questions posed by GASB, NFMA wishes to make the following comments regarding future accounting treatment for an issuer's pension expense:

- 1) To the extent state law requires a different accounting treatment of pension expenses, such difference should be footnoted and the effects of state law requirements on the issuer's statement of its pension expense should be tabulated so that calculations of pension expense under both GASB and state requirements can be compared.
- 2) The NFMA supports the continuation of separate reconciliation of each item of deferred inflow and outflow balance affecting pension expense, as described in Section 39 of GASB 27.

Questions 7 and 8: Governments in Cost-Sharing Plans

7. Do you agree or disagree with GASB's proposals that governments in cost-sharing multiple-employer plans report a liability equal to their long-term proportionate share of the collective net pension liability? Why do you agree or disagree?

We agree that governments in cost-sharing multiple-employer pension plans should report a liability equal to their long-term proportionate share of the collective net pension liability. NFMA also recommends that information regarding the methodology for determining these proportionate shares be detailed in the pension footnote for the government's financial statements. In addition, percentages and trends regarding this information should be included. Highlights of the plan (especially fair value of pension assets, pension liabilities, the net pension liability, and funded ratio) should be provided, as should a URL link to the plan's financial statements. By providing this information, users of financial statements will be better able to analyze the financial condition of governments in cost-sharing multiple-employer pension plans

and to compare governments in these plans to those in single-employer and agent multiple-employer plans.

8. How would these proposals affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?

- (a) Recognition of a proportionate net pension liability would fill the current gap in pension information for governments in these types of plans and allow for better decision making regarding the creditworthiness of a particular government. It would also allow for greater ease in comparing governments in different types of pension plans.
- (b) Pension data is extremely important to assessing a government's accountability and financial condition; this proposal will provide data that is critical to the work of municipal credit analysts.
- (c) This proposal, along with the additional footnote disclosure enumerated above and in the RSI, will allow for an assessment of interperiod equity by highlighting 1) a particular government's trend in net pension liability and 2) the current impact of that government's future commitments.

Questions 9 and 10: Note Disclosures and Required Supplementary Information

9. Do you agree or disagree with GASB's proposals regarding note disclosures and RSI? Why do you agree or disagree?

10. How would these proposals affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?

In general, NFMA agrees with GASB's proposals regarding note disclosures and RSI. In particular, we note the following:

- Regarding disclosure standards included in paragraph 32 of the Exposure Draft (ED), we recommend that if a pension plan issues a stand-alone financial report, access to such a report be available via an internet link.
- In paragraph 35 of the ED, NFMA recommends that access to a referenced document be provided via an internet link.
- In paragraph 42 of the ED, NFMA suggests that when appropriate, i.e. given funding situations, the table "Schedule of the Net Pension Liability" on page 123 of the document be added to the bottom of the table "Schedule of Changes in the Net Pension Liability", on page 122.

- In Illustration 2, for "Sample County", there is a disclosure on page 118 entitled "Retired Life Mortality". In our opinion, this section was unclear and we remain uncertain of its value.

GASB's proposals regarding note disclosure and RSI are extensive, but if adopted the information provided by them would be extremely useful in analysts' evaluations of state and local pension plans.

Questions 11 and 12: Special Funding Situations

11. *Do you agree or disagree with GASB's proposals regarding special funding situations? Why do you agree or disagree?*
12. *How would these proposals affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?*

The NFMA agrees with GASB's proposals regarding special funding situations. These proposals would make clear which entities are responsible for respective amounts of pension funding and liability and thus would meet NFMA's goals of making financial disclosure both more transparent and indicative of economic reality.

- a) The proposals would be useful in that they should make clear the absolute and relative funding responsibilities of parties in special funding situations. This in turn would assist in assessing these entities' creditworthiness.
- b) Ability to assess a government's accountability would also be enhanced, for the reasons described in both 11 and 12 (a) above.
- c) These proposals do not seem to be intended *per se* to address the criterion of interperiod equity and we think they would have little effect on that goal.

Questions 13 and 14: Defined Contribution Pensions

13. Do you agree or disagree with GASB's proposals regarding governments participating in defined contribution pension plans? Why do you agree or disagree?

We agree that governments participating in defined contribution pensions should essentially continue to follow existing requirements, as these requirements adequately capture financial information related to these plans.

14. How would these proposals affect any or all of the following: (a) usefulness of the information to the analyses you perform, the work you do or the decisions you make; (b) your ability to assess a government's accountability; and (c) your ability to assess interperiod equity?

- a) We believe this will provide consistency between government plans, making the data more useful for analysis.
- b) As long as there is consistency across municipalities, we believe that with the recommended financial accounting and disclosures, we would have adequate ability to assess a government's financial position.
- c) As in the case of 12 (c) above, These proposals do not seem to be intended *per se* to address the criterion of interperiod equity and we think they would have little effect on that goal.

The NFMA would like to thank you for the opportunity to comment on the Plain Language Supplement, and appreciates the efforts GASB is taking to improve pension reporting disclosure by municipal entities. Please feel free to contact me if you would like to discuss these comments at greater length.

Sincerely,

/s/

Gregory A. Clark

NFMA Chairman

