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Mr. David R. Bean  
Director of Research and Technical Activities  
Project Nos. 34-E and 34-P  
Governmental Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Bean:

We appreciate the opportunity to provide our comments on the Governmental Accounting Standards Board (GASB) Exposure Drafts (EDs), *Accounting and Financial Reporting for Pensions as amendment of GASB Statements No. 27 (Employer)* and *Financial Reporting for Pension Plans (Plan)*.

We agree with many of the overall tenets of the EDs, including the Board's view that the employer's unfunded accrued benefit obligation meets the definition of a liability; that the net pension liability is measureable with sufficient reliability; and that the projection of benefit payments should include cost of living adjustments (COLAs), ad hoc COLAs, future salary increases, and future service credits. However, we believe significant changes are needed before the EDs can be issued as final. These concerns are addressed in the following section of this letter.

### ***Unconditional Special Funding Situations***

We do not believe the pension amounts (net pension liability, deferred outflows, deferred inflows, and pension expense) should be allocated based on the notion of an unconditional legal obligation as discussed in Paragraphs 74 - 78 of the Employer ED. The Board's definition of an unconditional special funding situation—that the legal responsibility of the nonemployer contributing entity to contribute is unconditional,—is flawed in two respects. First, the legal responsibility may not be clear in statutes and thus would have the potential for widespread misinterpretation and inconsistent application. Second, there often is not a substantive difference between a conditional and unconditional special funding situation. For example, if a nonemployer government is required to contribute a percentage of income tax revenue, it is our understanding this is considered a conditional special funding which would not result in the nonemployer government recognizing any pension amounts. However, if the nonemployer government is required in statute to contribute a certain amount each year, but the funding source is not specified, this would be considered an unconditional special funding situation for which the nonemployer government would be required to recognize a relative proportion of the pension amounts. We do not understand how these two circumstances are substantively different.



We believe the *entire* liability should be recorded by the entity that is considered the primary obligor. In most cases, we believe this will be the employer because the underlying exchange transaction occurs between the employer and the employee. However, we do believe in certain circumstances, a nonemployer government (i.e. state) may be the primary obligor in circumstances in which it has legal responsibility for the payment of benefits.

### ***Allocation of Collective Pension Amounts for Cost-Sharing Plans***

We have significant concerns of whether the employer's share of the collective unfunded pension obligation is measurable with sufficient reliability for recognition in the financial statements. We believe all potential allocation methods, including projected contributions, covered payroll, and required contractual amounts, have conceptual flaws that have the potential for significant shifting of liabilities from one employer to another from year to year due to reallocation (change in proportion) which could affect the reliability, consistency, and comparability (and therefore the relevance) of pension information presented by cost-sharing employers.

We recommend the Board establish a separate project to evaluate the potential reliability and methodology of allocating the collective pension amounts to participating employers. As an interim measure until further evaluation can be performed, the Board should remove the allocation requirement in the current proposed standard and require employers to provide additional quantitative and qualitative disclosures about their participation in a cost-sharing plans including the collective pension amounts of the plan and the employer's portion of contractually required contributions.

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

We disagree with the Board's discount rate proposals in paragraphs 22 - 25 of the Employer ED, in paragraphs 40 - 43 of the Plan ED, and as illustrated in Appendix C. We believe it is illogical to allow employers to take credit for future contributions. Such action would allow the utilization of the investment rate of return for most underfunded plans. We believe the blended discounting convention will apply only to a relatively small percentage of the plans and will make it appear that most underfunded plans will achieve full funding. This could result in a pension liability that is significantly lower than the economic reality. Further, it does not seem logical to use a long-term investment rate of return in the discount calculation at a time when the plan is liquidating assets. This is especially the case as it gets close to the crossover point. In such a situation, it would not be realistic for the plan to invest the funds on a long-term basis.

We strongly encourage the Board to simplify the discount rate calculation. We recommend the Board calculate the funded portion using the 'run-off approach' as suggested by the AICPA. The run-off approach assumes no future contributions nor earned credits to the plan and consists of a projection of cash flows that would be performed to include projected asset growth based on the long-term rate of return and benefit payouts assuming no future service by the employees (similar to a frozen plan). We believe the "run-off approach" will result in a funded portion that is close to the actual funded level of the plan. With regard to the unfunded portion, we recommend the



use of a long-term return on operating funds. We believe this will eliminate the conceptual problem of combining a funding approach and a liability settlement approach in calculating a single blended discount rate.

### ***Allocation Method for Cost-Sharing Multiple-Employer Plans***

As previously stated above, we recommend the Board establish a separate project to evaluate the potential reliability and methodology of allocating the collective pension amounts to participating employers. If the Board rejects this recommendation, we advise the Board to consider alternative methods for allocating collective pension amounts to the participating employers. Although each potential allocation method has its flaws, we believe the projected long-term contribution effort allocation methodology is too subjective to be applied consistently and could lead to different allocation percentages established by the plan and the participating employers based on nonsubstantive factors.

We believe a more simplified allocation approach based on covered payroll would provide a reasonable and straightforward methodology. We believe that given the relatively stable workforce in governments allocating based on covered payroll would provide a similar result as the Board's proposal, but would alleviate some of the disparity in practice. We understand the Board may have concerns that such a covered payroll approach could adversely affect smaller employers. If that is the case, we recommend the Board explore some type of normalized or average covered payroll approach that would alleviate some of the negative impact on smaller employers based on short-term fluctuations in covered payroll.

### ***Essential Information Regarding Allocation of Collective Pension Elements in Cost-Sharing Multiple-Employer Plan Financial Statements***

As previously stated above, we recommend the Board establish a separate project to evaluate the potential reliability and methodology of allocating the collective pension amounts to participating employers. If the Board rejects this recommendation, we have significant concerns that the Board's proposal does not address how the participating employers will obtain sufficient, reliable, and verifiable information on which to base the reporting of their proportionate share of the collective net pension liability, collective pension expense, and collective deferred outflows of resources and collective deferred inflows of resources related to pensions. There are a wide range of potential solutions to this problem. We believe the Board is in a position to alleviate some of the burden of facilitating the exchange of reliable and verifiable information between plans and employers through the plan's financial reporting package.

Consistent with the recommendation provided by the AICPA, we believe the most effective way for the Board to address this issue would be to require a statement of the allocation basis for each employer as a basic financial statement or a required note disclosure for each plan. Such allocation information is essential to one group of primary users of plan financial statements—the participating cost-sharing employers—and would not be detrimental or misleading to other users. Using this recommendation for the allocation method described in the previous comment, the statement would present each employer's covered payroll. Including the information as a



statement or required note disclosure would subject it to audit and would provide reliable and verifiable information for participating employers to assess when reporting their share of pension elements. While we recognize that providing this statement or required disclosure would require additional efforts by the plans and their auditors, we believe it would go a long way in alleviating requests of the plan by each cost-sharing employer (which in some cases number in the thousands) to verify its allocation.

***Essential Information Regarding Employer Interest of Plan Net Position in Agent Multiple-Employer Plan Financial Statements***

Similar to the issues raised for cost-sharing multiple-employer plans, we have significant concerns that the Board's proposal does not address how the participating agent employers will obtain sufficient, reliable, and verifiable information to determine their interest of plan net position to record. As required by the EDs, the agent employer should measure plan net position using the same valuation methods that are used by the plan. Participating employers would not have information needed to perform such a valuation nor assess the plan's valuation without direct access to the plan and its records. We acknowledge that there are a wide range of potential solutions the Board can explore to address this issue. Consistent with the recommendation provided by the AICPA, we believe the most effective solution would be for the Board to require plans to include a statement of each employer's interest of plan net position as of the plan's year-end as a basic financial statement or required note disclosure. We believe such information is essential to one group of primary users of plan financial statements—the participating agent employers—and would not be detrimental or misleading to other users. Including this information as a statement or required note disclosure would subject it to audit and would provide reliable and verifiable information for agent employers to assess when reporting their interest of plan net position.

While we recognize that providing this statement or required disclosure would require additional efforts by the plans and their auditors, we believe it would go a long way in alleviating requests of the plan by each participating employer (which in some cases number in the thousands) to verify its interest of plan net position.

***Frequency of Measurement for Multiple-Employer Plans for Differing Year-Ends***

We recognize that additional measures will still be necessary for plans, participating employers, and related auditors in order to facilitate reporting for those employers that have a year-end that differs from the plan's year-end. To address this timing difference directly, one option would be to change the timing for employer accounting and reporting for plan net position to a valuation within 3 months of year-end. Plans could then perform quarterly valuations of plan net position and provide employers access to verify the information or, to alleviate the interaction with the employers, could engage an auditor to audit the quarterly net position information of the plan. While valuations concurrent with the year-end of each employer would provide the timeliest information, we recognize that the burden such reporting would put on a plan may be excessive. Therefore, the quarterly approach would be a practical solution.



***Changes in Proportion of Cost-Sharing Multiple-Employer Plans***

We disagree with deferring and recognizing in future periods the net effect of a change in the proportion used to calculate the employer's share of the collective net pension liability and collective deferred outflows of resources and collective deferred inflows of resources related to pensions as described in paragraph 60 of the Employer ED. In our view, this deferral adds unnecessary complexity and presents disparity in the treatment of changes by cost-sharing employers versus single and agent-employers. We believe changes in proportion have no economic benefits to future periods. We recommend the Board revise the proposed treatment of the net effect of a change in proportion to expense any such change in the current period.

***Investment Performance Disclosure***

We strongly encourage the Board to provide more specific guidance on the calculation of the investment performance information. We believe the guidance currently included in the Plan ED will result in significantly different interpretations and application. We recommend the Board more closely align with requirements with the Global Investment Performance Standards.

We also have significant concerns about the requirement to disclose investment performance information in the notes to the financial statements because of the practicality (and potential additional cost) of auditing such information that is based on multiple fair value measurements throughout the year. We believe the more appropriate placement is in the required supplementary information.

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If you have any questions or need additional information regarding our comments, please contact Mr. Jeffrey Markert at 212-909-5306 or [jmarkert@kpmg.com](mailto:jmarkert@kpmg.com).

Very truly yours,

**KPMG LLP**