Letter of Comment No. 61
File Reference: 34-E
Date Received: 10/3/11

National Association of State Auditors, Comptrollers and Treasurers

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September 30, 2011

Mr. David Bean
Director of Research
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the National Association of State Auditors, Comptrollers and Treasurers, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's Exposure Draft (ED), *Accounting and Financial Reporting for Pensions*, an amendment of GASB Statement No. 27.

As stated previously in our July 29, 2009, response to the GASB's Invitation to Comment (ITC), *Pension Accounting and Financial Reporting*, and our September 17, 2010, response to GASB's Preliminary Views (PV), *Pension Accounting and Financial Reporting by Employers,* we prefer the net pension obligation (NPO) approach over the net pension liability (NPL) approach. We remain concerned with GASB's contention that funding for government pension plans can be completely separated from employer's accounting and reporting for such plans. With this in mind, our comments that follow pertain to the proposed standards contained in the ED without focusing on our preference for the existing NPO approach.

In general, we believe the ED correctly applies the developments from Concept Statements No. 3 and 4. The proposed standards together will result in increased accountability for the current and cumulative prior period effects of the employment exchange implicit in providing governmental pensions. Overall, the proposed standard should enhance the consistency, transparency and value of financial reporting for government pensions.

However, we are particularly concerned how these amendments will impact the *timeliness* of financial reporting for cost-sharing defined benefit multiple-employer plans since the calculation of the proportionate share of net pension liability will be time consuming for the plans, and each employer's reporting is delayed until that information is received from the plans. Therefore, we are very concerned that the proposed standard will result in significant delays in financial reporting.

Below we have provided comments and concerns we believe the board should consider as it finalizes this statement.

Paragraph 12
The special funding situations described in this paragraph indicate that the nonemployer contributing entity is legally responsible for contributions to a pension plan. We recommend the Board include additional explanation or definition for "legally responsible." Please clarify if legal responsibility requires a legal agreement, historic tradition or annual appropriation. We believe additional explanation will minimize confusion on the applicability of this requirement.

Paragraphs 18 and 49
We agree with the Board that actuarial valuations should be performed at least biennially. Requiring annual valuations could affect the timeliness of financial reporting and be a cost burden, especially to smaller employers. However, we fail to see how requiring the valuation be updated as of each employer's financial statement date is significantly different than an annual valuation. An update will most likely require the services of an actuary. The paragraphs mention the use of "update procedures" to roll forward amounts to the end of the plan's reporting period. It would be helpful to have additional guidance regarding the specific procedures that may be considered appropriate "update procedures." Lack of direction could impair the comparability of financial statements across governments.

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Paragraphs 20 and 51

- The decision to include or not include projected ad hoc COLAs and other ad hoc postemployment benefit changes, to the extent that they are considered to be substantively automatic, in the projected benefit payments has a significant effect on the calculation of the projected future benefits and the related pension liability. Accordingly, the Board should consider providing additional guidance to ensure consistent application of the "substantively automatic" provisions.

- If it is the GASB's intent that "pensions that are in force at the actuarial valuation date" are for current and former employees and exclude the service costs and contributions of future employees as spelled out in paragraphs 23 and 54, that should also be specified in paragraphs 20 and 51.

Paragraphs 26 and 57
We agree that the entry age normal actuarial cost method should be used to attribute the actuarial present value of projected benefit payments. However, some readers may need clarification of paragraphs 26.d. and 57.d. which state "service costs of all pensions should be attributed through all assumed exit ages, through retirement." We suggest the Board provide a clearer definition such as "through latest projected exit date."

Paragraphs 28.a.(4)b. and 59.a.(4)b.
The Board should consider providing guidance regarding the calculation of "average expected remaining service life." By not specifying a particular method, the consistency and comparability of pension information among plans may be reduced.

Paragraphs 28.b.(1) and 59.b.(1)
These paragraphs require investment earnings be included in pension expense. Please consider adding "(reduce)" to this sentence, similar to the wording used in paragraph 232. We believe inclusion of the word "(reduce)" in these paragraphs would clarify the Board's intent.

Paragraph 31
Please clarify if the note disclosures for single or agent employer pension plans should separately identify amounts associated with fiduciary funds in which employees' salaries and pension benefits are reported as administrative expense. It would also be beneficial to address whether pension expense and Net Pension Liability associated with the administration of fiduciary funds should be allocated to the fund level statements or included in the government-wide statements where fiduciary balances are normally excluded.

Paragraphs 34 and 67
These paragraphs require disclosures of assumptions made and how those assumptions were determined. Because these are assumptions of the plan, we believe the Board should consider requiring how the assumptions were determined to be disclosed only by the plan, and not by the employers. Employers could refer financial statement users to the plan's financial statements.

Paragraph 34.e
This paragraph requires disclosure of the effects of a 1-percentage-point increase and a 1-percentage-point decrease in the discount rate. It is not clear whether the 1-percentage-point is applied at the level of the single rate that reflects the two underlying rates or at the level of the individual underlying rates. However, paragraph 56 does specify that the single rate equivalent to the application of the two underlying rates is the "discount rate for purposes of this statement." We do not believe it is appropriate to apply the increase/decrease measurement at the single rate level. In the current environment a 1-percentage-point change in the long-term investment rate of return represents a plus or minus 12.5 percent change while a 1-percentage-point change in a high quality bond index represents approximately a 25 percent change. It should also be considered that the underlying rates are unlikely to move in the same direction (or in the same proportion) in an actual market change. For these reasons, we believe the Board should require this 1-percentage-point sensitivity disclosure to be applied only to the underlying long-term investment rate of return with recalculation of the resulting single rate.

Paragraphs 42.a.(1) and 42.b.(1) and (2)
The related illustrations duplicate the presentation of total pension liability, the amount of plan net position and the net pension liability. Paragraph 42.b.(1) and (2) only add the funded ratio, covered payroll, and the percent that net pension liability represents of covered payroll. We believe the three additional items required by 42.b.(1) and (2) should be presented in the schedule required by 42.a.(1). Schedule titles should be changed to reflect the consolidation of the information.

Paragraphs 44 through 71
Paragraph 15 indicates the primary government and its component units should account for and report their participation in the same plan as if they are cost-sharing employers when presenting information in their stand-alone financial statements. We believe the cost-sharing employer reporting requirements in paragraphs 44-71 create a burden on the pension plan to provide this detailed information to the multiple component units. Also, the pension information reported by the component units will be redundant to that reported by the primary government. We recommend the Board revise the standard to allow the component unit to reference the disclosures in the primary government's annual financial report.

Paragraphs 44 and 62
It would be helpful if the Board would describe methodologies for attributing the employer's proportionate share of the collective net pension liability, collective pension expense, and the related collective deferred outflows of resources and collective deferred inflows of resources to multiple reporting units for an entity that has multiple reporting units.

Paragraph 46
This paragraph uses the term "long-term contribution effort" without defining the term. Many factors affect the projection of contribution effort – the most difficult of which to estimate is the proportional mix. This estimate requires a cost sharing employer to not only estimate its own long-term employee count and wage growth, but to also have the same information from all other participants in the cost sharing multiple employer plan. That information may not be available to CAFR preparers. We believe GASB should define long-term as the average remaining service life of the employer's employees and require cost-sharing multiple employer (CSME) plans to accumulate and present the collective CSME participant estimates of long-term employee count and wage growth. This will avoid the inefficiencies inherent in each participant requesting the information from all other participants. In addition, the last sentence of paragraph 46 implies that use of the employer's proportion established at the valuation date is only valid if no significant change occurs between the valuation date and the employer's fiscal year end. The sentence does not explain how an individual employer would assess the significance of a proportion change or measure the change in the proportion when they may not be party to the events that caused the proportion to change. If the Board believes the proportion calculation will be the responsibility of the plan, we believe that requirement should be included in the related plan reporting ED.

Paragraphs 49 and 58
Requiring measurement of plan net position as of the fiscal year end for each employer's reporting period could result in additional time and cost for multiple-employer plans if, as is often the case, those employers have different fiscal year ends. The timeliness and related costs will become an issue for some plan sponsors and employers. We believe the Board should allow the use of a valuation within six months of the reporting entity's fiscal year end. Pension plans are entities with long-term horizons that should not be required to respond with reporting changes to events inside a six month window.

Paragraph 57
We believe clarification is needed for item d. in paragraph 57, which states, "The service costs of all pensions should be attributed through all assumed exit ages, through retirement." This text implies there is more than one assumed exit age. Item a. requires that attribution of present value of projected benefit payments be made on an individual employee-by-employee basis. If there is only one expected exit age per individual, the language in item d. is not compatible with the language in item a. If item d. is intended to address the probability weighing for various exit dates used in actuarial valuations, that should be

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explained or made clear in the standard. Since this proposed standard is directed to employers, we believe that actuarial processes should not be referenced without at least some explanation.

Paragraph 58
The requirement that the plan's net position be measured as of the end of the employer's reporting period could seriously hamper the production of timely financial statements since employers in a multiple employer cost-sharing plan could have different fiscal year ends.

Paragraph 59.b.(3)
This paragraph states, "All other changes in plan net position should be included in collective pension expense in the period of the change." Projected earnings reduce pension expense and variances between projected and actual earnings are deferred and amortized as pension expense per 59.b.(1) and (2). Employer contributions increase plan net position (as shown in Illustration 2 on page 119), but they are not included in the pension expense sample disclosure (as shown in Illustration 2 on page 120). We are unclear as to why the illustration (page 120) seems inconsistent with paragraph 59.b.(3), and we believe that employer contributions should be shown as reduction of pension expense in that illustration.

Paragraph 61
This paragraph requires additional complex calculations regarding an employer's contributions. The deferral over employees' expected service lengthens the time to record these entries, and every year will bring a new deferral. We believe the cost of the many requirements for deferred entries outweighs the benefits of these calculations.

Paragraph 67(b)
The Board should consider requiring a disclosure of investment policy, law, or regulation that could prevent investment in long-term assets for paying pension benefits. The purpose of such a disclosure would be to allow the reader to determine if the entity is limited to investing in lower-return short-term investments.

Paragraphs 70.a and 70.b.(1) through (3)
The related illustrations duplicate the presentation of total pension liability, the amount of plan net position, and the net pension liability. Paragraph 70.b. only adds the funded ratio, covered payroll and the percent that net pension liability represents of covered payroll. We believe the three additional items required by 70.b. should be presented in the schedule required by 70.a. Schedule titles should be changed to reflect the consolidation of the information.

Paragraph 71
The last sentence states that "the amounts reported for prior years should not be restated." We are confused as to what types of restatements this directive is referring. Specifically, it is unclear whether the directive refers solely to updates for changes in demographic information and actuarial assumptions or if it also requires that errors made in prior year disclosures should not be corrected. We suggest the Board clarify the statement.

Paragraphs 90.a and 90.b.(1) through (3)
The related illustrations duplicate the presentation of total pension liability, the amount of plan net position and the net pension liability. Paragraph 90.b. only adds the funded ratio, covered payroll and the percent that net pension liability represents of covered payroll. We believe the three additional items required by 90.b. should be presented in the schedule required by 90.a. Schedule titles should be changed to reflect the consolidation of the information.

Paragraph 96
The third sentence of this paragraph requires recognition of a pension liability for a defined contribution plan for the difference between pension expense and actual contributions made. We believe the Board should specify the accounting and reporting requirements if the actual contribution exceeds the pension expense. If the Board believes the pension expense will always be at least the amount contributed, then

Letter of Comment No. 61
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the guidance should specifically address the amount by which the pension expense exceeds the actual contribution rather than citing just the difference between those amounts.

Paragraph 107
We encourage the Board to simplify the effective date requirements by having a single effective date. We suggest it to be for periods beginning after June 15, 2013.

Paragraph 110 (Glossary)

- The definition of “automatic COLAS and other postemployment benefit changes” states that they include “those for which the amounts are determined by reference to a specific factor (such as the earnings experience of the plan).” Paragraph 166 notes that automatic postemployment benefit increases include “gain sharing features.” We suggest that the Board provide additional guidance and/or illustrations on how these plan earnings and gain sharing features should be considered when projecting benefits.

- It would be helpful if the Board would expand the definitions of “Active employees” (page 43) and “Inactive employees” (page 45) to deferred retirement option programs.

- The board might want to consider adding a definition of “Discount rate" to the glossary.

Paragraphs 157 and 158 (Basis for Conclusions and Alternative View)
We believe the cost of rolling forward liability valuations and measuring net position will be little different than a requirement for annual valuations for small plans and will add significant cost for large multiple employer plans having multiple employer’s year end dates. We believe the Board can accomplish its objectives and minimize adverse effects on timeliness of financial reporting by requiring the valuation date to be within six months of the employer’s year end date.

Paragraph 291 (Illustrations)

- General: Deferred inflows of resources and deferred outflows of resources are not illustrated. This is a significant change on the face of the statements and we would like to see expanded illustrations that include these items, as well as other statement illustrations.

- General: The addition of a graph(s) or other illustrations in the appendix that illustrates the pension benefit projection period, the discount period and attribution period would be helpful to users in understanding and implementing the proposed standard's requirements.

- General: It would be beneficial for the Board to provide a comprehensive illustration that shows how a PERS disclosure supports an employer’s accounting and reporting of Pension Expense, Net Pension Liability, and deferred items. Such an illustration should include required journal entries and the source of the amounts in the journal entries.

- Page 120: We believe the word “actual” in the second line of text following pension expense should instead be “active.”

- Page 127: The Board should consider showing in tabular format (similar to Illustration 2 on pages 119 and 121) the financial information shown narratively in the “Net Pension Liability and Deferred Outflows of Resources and Deferred Inflows of Resources for Pensions” section.

General Comment
Our members have increasingly expressed concerns about complexity in the accounting and reporting standards. Many of the sentences in this document are very long, encompassing five or more lines of text. Please consider breaking up these sentences into shorter, more readable thoughts. The use of bullets or numbered indentations might help to break up these long sentences. Paragraphs 13 and 41 are good examples of using bullets or numbered items. The first example of a very long sentence is paragraph 12 in which the third sentence takes up over seven lines. Consider placing a period after “(b)

unconditional." Consider putting definitions of the terms in the glossary. Paragraph 74 would also benefit by putting definitions of the terms in the glossary. Other examples are paragraphs 15, 21, 22, 40, 51, 61, 69 f, 73, 81, 82, 89 f, 89 g, 96, 103, 132, 133, 164 and 191. See also footnote 5.

We appreciate the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Kim O'Ryan of NASACT at (859) 276-1147 or me at (334) 242-9200.

Sincerely,

Ronald L. Jones

Ronald L. Jones
NASACT President