

October 14, 2011

Director of Research and Technical Activities Governmental Accounting Standards Board 401 Merritt 7, PO Box 5116 Norwalk, CT 06856-5116 Via email: director@gasb.org

Re: Projects No. E-34

Dear Members of the GASB:

The Texas Municipal Retirement System (TMRS or the Plan) is pleased to have the opportunity to respond to the Government Accounting Standards Board's (GASB) Exposure Drafts (EDs) on "Financial Reporting for Pension Plans" and "Accounting and Financial Reporting for Pensions."

TMRS is a statewide agent multiple-employer retirement system created by the Texas Legislature in 1947 to provide retirement, disability, and death benefits to employees of participating municipalities in the State of Texas. The TMRS Act places the general administration and management of the System with a 6-member Board of Trustees. Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas.

TMRS administers a nontraditional, joint contributory, hybrid ("cash balance") defined benefit plan for over 840 participating employers covering over 141,000 members and 38,000 retirees and beneficiaries. Each employer participating in TMRS is financially responsible for the benefits of its own members, retirees and beneficiaries.

We have focused most of our comments and recommendations on the issues of primary concern to TMRS which include the following:

- 1. The general complexity and volatility of the new measures relative to current measures;
- 2. A safe harbor exemption from blended discount rate calculations for actuarially sound employers;
- 3. A smoothed versus market value of assets;
- 4. Plan year-end versus fiscal year-end reporting date for participating employers;
- 5. The short implementation timeline relative to the time needed to effectively communicate new standards; and
- 6. The excessive costs and magnitude of the effort required for compliance relative to the degree in which the GASB's key objectives are met.

October 14, 2011 Page 2

We understand the GASB's concerns about considering changes to the pension accounting and financial reporting standards and agree with the GASB that a need exists for increased transparency and accountability for plans, employers, and plan sponsors. We philosophically disagree, however, with the GASB's decision to completely "divorce" pension accounting from pension funding and believe the magnitude of the changes as proposed in the EDs will greatly reduce decision usefulness and accountability. Specifically, we believe the Net Pension Liability (NPL) and Pension Expense (PE) under the proposed standards will exhibit excessive volatility and are unnecessarily complex measures. The long-term perspective of funding standards applicable to and used by state and local governmental employers coupled with a short-term, volatile approach to accounting and financial reporting will be extremely difficult to explain to interested parties and will require significant communication efforts and expense without increasing accountability or providing more decision useful information.

GENERAL COMMENTS

The current accounting standards for public pension plans have become the de facto funding standard for many public funds and have helped provide a benchmark for plans to meet. In many respects, the Annual Required Contribution (ARC) and its disclosure in the notes to the employer's financial statements is the barometer of the pension plan's progress in meeting its funding obligation. There is concern that by separating accounting from funding, the benchmark will be eliminated, potentially leading to even more divergent funding methodologies than exist today. Accounting and funding do not have to be identical, but we believe there is considerable value in both having a similar long-term perspective.

We believe the ARC and Net Pension Obligation (NPO) in the current standards come closer to providing accountability and information that is useful in the decision making of public plan sponsors and governing bodies, analysis by credit agencies, disclosure to taxpayers and understanding by plan members. Furthermore, we believe the ARC is the best measure of the employer's long-term cost of pension benefits as it reflects the best estimate of the employer's long-term contributions. In contrast, the PE is based on changes in the NPL, adjusted for certain deferred inflows and outflows, and would not be a useful measure of long-term costs. Additionally, we believe the ARC is a much more stable measure than the PE, which may be quite volatile.

We agree conceptually that an obligation exists by the employer; however, we have concern with recognizing the NPL on the balance sheet. Concepts Statement 4, paragraph 17, defines financial statement *liabilities* as "present obligations to sacrifice resources that the government has little or no discretion to avoid." The assumption that the pension obligation is essentially unavoidable was the basis for GASB's decision to treat it as a liability and to require the NPL be reflected on the employer's balance sheet. The GASB appears to make the assumption that the employer or plan sponsor has little or no discretion to avoid a sacrifice of its resources to fulfill the obligation. Numerous states around the U.S. have recently made substantial decreases in benefits to prospective members, active members, and even benefit recipients. In the TMRS plan, for example, participating employers can and have adopted lower matching ratios and have reduced or eliminated other benefit options, including cost-of-living adjustments, resulting in significant reductions in plan liabilities. In the last three years alone, the cumulative

October 14, 2011 Page 3

reduction in TMRS plan liabilities due to benefit decreases adopted by participating employers is in excess of \$775,000,000. Because the participating employers in TMRS have wide discretion to decrease benefits and their funding obligations by Ordinance adoption, we believe the NPL does not satisfy the Statement 4 definition of liability for inclusion on the financial statements. Consequently, we believe the NPO under the current standards is the best measure of an employer's pension liability for placement on the financial statements and its use should be retained.

Finally, we believe the elimination of the ARC and NPO will make the financial statements less useful to the reader. In addition, the introduction of two sets of numbers, one for funding and one to satisfy the GASB accounting requirements, will lead to confusion regarding which are the "real" numbers and further harm decision usefulness. We respectfully request that the GASB reconsider its decision to separate pension accounting from pension funding and retain an ARC based approach for determining pension expense and retain the use of the NPO for liability recognition in the financial statements.

COMMENTS REGARDING THE NET PENSION LIABILITY AND PENSION EXPENSE

In the event that the GASB decides to continue on the implementation path outlined in the EDs, we offer the following recommendations and comments for consideration prior to issuance of the final amended statements.

I. We recommend that the GASB include "safe harbor" exemptions from the discount rate calculation in order to reduce the costs of compliance.

Due to the potentially excessive additional costs associated with determining the blended discount rate for each of our 840+ participating employers, we recommend exempting each employer from this calculation if either:

- 1. The employer contribution policy is on an actuarial basis with
 - **a.** A closed, level percent of payroll amortization over a period of 30 years or less, and
 - **b.** The employer has a history of making the full actuarial contribution, and
 - **c.** The plan is open to new entrants, or
- 2. The market values of plan assets exceed the actuarial accrued liability at the valuation date and the employer has a history of contributing on an actuarial basis.

II. We recommend asset values are smoothed in determining the Plan Net Position (PNP) and NPL.

In order to better reflect a long-term measure and to reduce the volatility in the NPL due to short term fluctuations in the market value of assets, we recommend that the PNP be based on a smoothed value of assets over a period of at least 5 years.

October 14, 2011 Page 4

III. We recommend the use of the plan's fiscal year-end date to determine each participating employer's NPL, PE and deferred inflows and outflows.

Given that the fiscal year-end dates of most participating employers in TMRS do not coincide with the Plan's fiscal year-end date, we recommend use of the Plan's fiscal year-end date for determining each employer's Total Pension Liability (TPL), PNP and PE. While the proposed standards allow the TPL measures to be rolled forward, they require the PNP to be determined at the employer's fiscal year end. This effectively requires a monthly valuation of assets for each participating employer. The accumulation of monthly roll-forward data combined with the monthly valuation and allocation of assets among participating employers will be extremely costly without proportionately enhancing the accuracy of the measures.

If the GASB does not allow use of the Plan's fiscal year-end date to determine each employer's TPL, PNP and PE, TMRS is concerned about the logistics and practicality of providing updates for our 840+ employers. Some of our concerns are listed below:

- "Significant changes" (from the most recent measurement date to the employer's fiscal year-end) could be defined differently by our various employers and their auditors.
- It is unclear as to how an employer's auditor will gain "comfort" with the liability posted to the financial statements, especially when this proposed expense number can be volatile. There is the possibility for significant additional audit procedures and associated costs to our member municipalities.
- Roll-forward procedures could differ greatly among participating employers, resulting in inconsistency of results.
- The updating requirements of the GASB's EDs would cause some unwelcome increases in administrative expenses, especially for agent multiple-employer plan sponsors and their participating employers, without adding any meaningful precision.

IV. We recommend information presented in the Notes and Required Supplementary Information (RSI) be as of the Plan's fiscal year end.

While we agree with the GASB's intent for greater transparency with respect to pension obligations, we have some concerns about the proposed disclosure requirements. In an agent multiple-employer plan such as TMRS, employers may have fiscal year-ends in every month of the year. Requiring extensive disclosure for each plan member at different months throughout the year will create a tremendous administrative burden on the Plan, as well as to the city members. We believe that information presented as of the Plan's fiscal year-end would be the most accurate and relevant, and would provide the most comparability.

V. We strongly recommend that the effective dates of the proposed standards be extended for at least another year.

The GASB's proposed standards are extremely complicated and represent a fundamental change in how pensions are measured. As an agent multiple-employer plan that utilizes the Projected Unit Credit cost method for funding purposes, our consulting actuaries will

October 14, 2011 Page 5

have to perform two valuations for each of our 840+ participating employers at the Plan's fiscal year-end. In addition, the required monthly roll-forward of liabilities and allocation of PNP for each participating employer will need to be updated to their fiscal year-end. At the very least, many details still must be worked out for coordination between TMRS, the participating employers, actuaries and auditors.

In conclusion, we do not believe that a majority of the proposed changes reflected in the EDs will assist the GASB in meeting its goals of decision usefulness, accountability, transparency and intergenerational equity. The accounting standards proposed will produce pension expense and net pension liabilities that are too volatile to be utilized as a benchmark for funding and may not be truly representative of intra-period equity due to the long-term nature of public pension plans and the employers who fund them. Disconnecting the accounting and financial reporting from funding may lead to the accounting results being irrelevant to the business operations of the employers, the pension plans and ultimately to the users of the financial statements.

Again, we appreciate the opportunity to comment on this project. Should you have any additional questions regarding these comments, please feel free to contact our organization.

Sincerely,

David Gavia
David Gavia
Executive Director

cc: TMRS Board of Trustees