

## Public Pension Financial Forum c/o Ohio Public Employees Retirement System

277 E. Town Street

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March 16, 2012

Director of Research and Technical Activities Governmental Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

Subject: Project No. 13-3

Dear Board and Staff:

The Public Pension Financial Forum (P2F2) is pleased to have the opportunity to respond to the Government Accounting Standards Board (GASB) Project No. 13-3, Preliminary Views (PV) document on "Economic Condition Reporting: Financial Projections".

P2F2 was formed in 2004. The purpose of this organization is to promote excellence in public pension plan financial operations, provide educational programs of current interest to the membership, promote the exchange of ideas concerning financial operations and reporting between public pension plans, and to foster sound principles, procedures and practices in the field of public pensions related to the financial operations of such plans. Membership is open to any finance employee of a public pension who supports the purposes of P2F2. The organization currently has 179 members representing 114 plans, offering defined benefit, defined contribution and hybrid plans.

P2F2 is in general disagreement with GASB's PV on "Economic Condition Reporting: Financial Projections" as it relates to fiduciary funds, such as pensions and other post-employment benefit plans (OPEB). Pension and OPEB plans are designed, structured, and funded based upon a long-term outlook, reflecting a time-horizon covering an employee's career and a period of receipt of retirement benefits, a span of 50 to 75 years. Therefore, short-term financial projections are not appropriate for pension and OPEB plans. We do not believe these plans should be subject to the requirements of this PV.

Pension and OPEB plans are better served looking at long-term forecasts/projections, which adds a great deal of subjectivity. Sustainability is served by monitoring the long-term actuarial

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measures based on the funding method of the plan (funded status, progress on the ARC, amortization based on the known contribution approach). Short-term projections will be unreliable and misinterpreted, which could lead to inappropriate action.

## **GASB Questions:**

- **1.** The Board's preliminary view is that there are five components of information that are necessary to assist users in assessing a governmental entity's fiscal sustainability (Chapter 3, paragraph 2):
- Component 1—Projections of the total cash inflows and major individual cash inflows, in dollars and as a percentage of total cash inflows, with explanations of the known causes of fluctuations in cash inflows (Chapter 3, paragraphs 4–9)
- Component 2—Projections of the total cash outflows and major individual cash outflows, in dollars and as a percentage of total cash outflows, with explanations of the known causes of fluctuations in cash outflows (Chapter 3, paragraphs 10–14)
- Component 3—Projections of the total financial obligations and major individual financial obligations, including bonds, pensions, OPEB, and long-term contracts, with explanations of the known causes of fluctuations in financial obligations (Chapter 3, paragraphs 15–20)
- Component 4—Projections of annual debt service payments (principal and interest) (Chapter 3, paragraphs 21–23)
- Component 5—Narrative discussion of the major intergovernmental service interdependencies that exist and the nature of those service interdependencies (Chapter 3, paragraphs 24–26).

Do you agree with this view? Why or why not?

We do not agree that these are the right components for a long-term pension plan or OPEB plan. The cash flow projections give the user too much detail when projecting out many decades. We feel the long-term sustainability issue is better understood by utilizing actuarial measures based on the funding approach of the plan.

Component 1 and 2 as presented will be misunderstood and we feel adds little value and is not the right information for users of financial statements. While there is some ability to project the inflows and outflows of contributions and benefits, we do not feel there is a reliable approach to projecting the investment cash flows on a year-by-year basis over a short period of time. The largest investment cash flows for a typical large pension plan relates to investment asset turnover caused by normal trading activity and re-balancing and re-allocation of asset. These transfers will dwarf any other cash flows of a plan.

Component 3 – We have great concern about the reliability of providing the unfunded pension and OPEB liabilities. Typically, the largest contributor to a change in the unfunded liability is from investment gains or losses. As the proposed GASB ED on pensions now uses the market value of assets and most plans would use the assumed actuarial rate of return assumption to project the unfunded liability, the actual unfunded liability in the projection period will be much more volatile, which may cause the users of the financial statements to question the value and validity of this projection information. For multi-employer plans, we are also concerned about the

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timeliness and complexity of providing projected and allocated unfunded pension and OPEB liability figures out to the employers at the employers' year-ends (based on the current pension ED).

**2.** The Board's preliminary view is that financial projections should be (a) based on current policy, (b) informed by historical information, and (c) adjusted for known events and conditions that affect the projection periods. Current policy includes policy changes that have been formally adopted by the end of the reporting period, but that will not be effective until future periods. (Chapter 4, paragraphs 2–7). Do you agree with this view? Why or why not?

We believe the projection of uncertain outcomes (investment rates of return) is subjective and unreliable in the short-term.

We believe that known subsequent events that have a substantial and material effect on the projections, but not known at the end of the reporting period and, therefore excluded, will cause the projection to be misleading.

**3.** The Board's preliminary view is that inflows and outflows should be projected on a cash basis of accounting, and financial obligations should be projected on an accrual basis of accounting. (Chapter 4, paragraphs 8–12). Do you agree with this view? Why or why not?

We do not agree with the cash basis requirement for presenting investment inflows and outflows. Showing investment inflows and outflows, on any basis other than full accrual, will be misleading.

**4.** The Board's preliminary view is that the identification and development of assumptions for making financial projections should be guided by a principles-based approach. Such an approach would set forth principles that require assumptions to be based on relevant historical information, as well as events and conditions that have occurred and affect the projection periods. Furthermore, these assumptions should be (a) consistent with each other (where appropriate) and with the information used as the basis for the assumptions and (b) comprehensive by considering significant trends, events, and conditions. (Chapter 4, paragraphs 13–16). Do you agree with this view? Why or why not?

To make projections meaningful, the preparer will need flexibility and we believe the principles-based approach will best serve this purpose. But with the additional flexibility, users will lose comparability between plans.

**5.** The Board's preliminary view is that annual financial projections should be made for a minimum of five individual years beyond the reporting period for the purpose of external reporting. (Chapter 4, paragraphs 19–23). Do you agree with this view? Why or why not?

We believe that five years is inadequate for projections of pension and OPEB plans with time horizons of 50 to 75 years. We do not believe the current format is the proper approach for displaying long-term pension and OPEB plans regardless of the number of years chosen. Sustainability is served by monitoring the long-term actuarial measures based on the funding method of the plan.

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**6.** The Board's preliminary view is that all of the components of fiscal sustainability information are essential for placing the basic financial statements and notes to the basic financial statements in an operational or economic context, and, therefore, should be required and communicated as required supplementary information. (Chapter 5, paragraphs 7–12). Do you agree with this view? Why or why not?

We do not believe that projections meet the criteria for presenting information items in the RSI as defined in paragraph 44 of Concept Statement 3.

"RSI may include explanations of recognized amounts, analysis of known facts or conditions, or other information essential for placing the basic financial statements and notes to basic financial statements in context. However, RSI does not include (a) subjective assessments of the effects of reported information on the reporting unit's future financial position, (b) predictions about the effects of future events on future financial position, or (c) information unrelated to the financial statements."

We believe long-term forecasts/projections can be a helpful tool for most plans and their development is an excellent exercise in analyzing sustainability and understanding the sensitivity of the long-term health of the plan to certain factors. We do not feel the Comprehensive Annual Financial Report (CAFR) is the appropriate vehicle to communicate such projections. Generally, the CAFR is viewed as a historic document, not containing such forward looking information. We are concerned that including short-term or long-term projections will undermine the credibility of the CAFR due to the inevitable differences between the projection information and the actual results. Additionally, we are concerned about adding significantly more information to the CAFR, as we are currently struggling to prepare this lengthy document in a timely manner.

**7.** The Board's preliminary view is that all governmental entities should be required to report financial projections and related narrative discussions. (Chapter 5, paragraphs 13 and 14). Do you agree with this view? Why or why not?

As proposed in the PV, we believe that the reports of financial projections will be misleading, unreliable, and misunderstood for governments that derive a significant portion of their cash inflows from long-term investments.

We feel the short-term information, as proposed in the PV, for pension and OPEB cash flows will be misinterpreted, unreliable, and will lead to inappropriate decisions. Even if a pension or OPEB plan were to expand the reporting beyond the minimum five years, we believe the proposed reporting is not the proper approach to analyzing the long-term financial sustainability of a plan.

For defined contribution plans, we see no value in preparing these financial projections.

**8.** Do you believe that a phase-in period for implementing the reporting requirements for financial projections and related narrative discussions would be appropriate (for example,

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requiring governmental entities over certain dollar thresholds to implement first)? If so, what phase-in criteria would you recommend? (Chapter 5, paragraph 14)

Yes, we believe a phase-in criteria based on dollar thresholds are appropriate.

GASB Concepts Statement 1 states that for information in financial reports to be effectively communicated, it needs to possess six qualitative characteristics: relevance, reliability, comparability, consistency, timeliness, and understandability. As stated in the PV, "If the reporting of financial projections and related narrative discussions is to be effectively communicated, it needs to possess all six qualitative characteristics." We believe that the pension and OPEB plan arena is extremely ill-fitted to these proposed requirements to the extent that the financial projections for these plans would not meet all of the qualitative characteristics noted above.

We do believe in forecasts/projections and their role in analyzing and monitoring the long-term financial sustainability of plans; however, we do not believe this is the proper approach and that the CAFR is not the proper vehicle for communicating these forecasts/projections. If GASB were to continue to pursue developing projections for fiduciary funds such as pension and OPEB plans, we would be glad to discuss other more appropriate approaches.

This response was prepared by a collective effort of the P2F2 membership. By our e-mail submission, the P2F2 Board of Directors substantially agrees with the views presented in this response. However, there are some areas where one or more P2F2 directors may have a slightly different perspective which will be shared with GASB in their systems' separate responses to the ED.

Sincerely,

Dave DeJonge

President-Elect, P2F2