September 22, 2011

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board (GASB)
Project No. 34-E and 34-P
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Governmental Accounting Standards Board (GASB or the Board) on the exposure drafts entitled Financial Reporting for Pension Plans an amendment of GASB Statement No. 25 (ED No. 25) and the exposure draft entitled Accounting and Financial Reporting for Pensions an amendment of GASB Statement No. 27 (ED No. 27). The FMSB is comprised of 25 members (list attached) with accounting and auditing backgrounds in federal, state and local government, as well as academia and public accounting. The FMSB reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

I look forward to testifying on behalf of the FMSB at the hearings in San Francisco. As requested, the FMSB offers the following written comments regarding the exposure draft.

General Comments

The FMSB strongly supports the underlying premise of the two exposure drafts on pension accounting and reporting that have been issued by GASB. Although we have certain areas that we believe can and should be modified in the final pronouncement, the concept of recording a net pension liability is sound and should have far reaching effects by improving financial reporting for governments. The FMSB believes that pension benefits result from an exchange between an employer and an employee, and that the pension benefits are earned at the time the employee renders the services. This obligation is generally irrevocable upon vesting because the employer would have little or no discretion to avoid the obligation. This transaction meets the requirements of a liability as defined in Concepts Statement No. 4, paragraph 17 and if an employer has not set aside sufficient assets to pay for the pension benefits, a net liability amount should be recognized and reported on the statement of net assets. Furthermore, we believe it is the pension plan’s responsibility to receive inflows.
of resources and to accumulate these resources to pay for benefits. Our overall position remains consistent with previous statements made by the FMSB in our September 21, 2010 letter to GASB on the document entitled, *Pension Accounting and Financial Reporting by Employers*. There are several areas in the two exposure drafts for which we have comments and suggestions for improving the language of the final pronouncements. We have grouped our concerns by topic, as follows:

**Projection of Benefit Payments Issues**

Paragraph 20 in ED No. 27 and paragraph 39 in ED No. 25, describes the factors that should be included in the projection of benefit payments. We believe that certain improvements can be made to the wording of these paragraphs to reflect that adjustment factors can be both positive in nature or negative in nature which could, therefore, either increase or decrease the projected benefit payments. Both paragraphs state that the projected benefit payments should include, among other factors, the effects of automatic cost-of-living adjustments (COLAs), ad-hoc COLAs, and projected salary increases where benefits are based on future salary increases. In our response to the Preliminary Views document, we requested that the final language reflect that COLAs may be not only increases but decreases as well, especially in deflationary periods. We still believe that this should be addressed in the final standard. Although we are not aware of any pension plans that currently contain a provision to reduce benefits based upon deflation, such a provision cannot be ruled out in future pension plans given the current economic climate. We would suggest the glossary definition be adjusted to reflect this possibility.

Paragraphs 20 in ED No.27 and 39 in ED No.25 also state that projected benefit payments should include ad-hoc COLAs to the extent they are considered to be substantively automatic. A footnote in the exposure draft is used to detail what factors should be considered in deciding whether an ad-hoc COLA should or should not be included in the benefit projection. Given current economic conditions, there might be contravening evidence to suggest that an ad-hoc COLA should or should not be taken into account when calculating the projected benefit payments. An employer may have a history of granting ad-hoc COLA increases in the past but be reluctant to continue this practice in the future due to economic constraints. As we stated in our letter of September 21, 2010 to the Board, we believe that GASB should include a more objective measure as to what demonstrates that an ad-hoc COLA is or is not substantively automatic. We had suggested that such a criteria might be that a COLA will be considered to be substantively automatic if one had been granted in 4 of the 5 preceding calendar or fiscal years. The employer might also have evidence to suggest that such ad-hoc COLAs will not be granted in the future. Given the potential significance of this matter, we suggest that the final document require the employer to demonstrate that future intentions have been formalized in an appropriate manner by the government.

Paragraphs 20 in ED No.27 and 39 in ED No.25 further states that “projected salary increases” should be included in the calculation, if the pension is based upon future compensation levels. It should be noted that some state and local governments have recently negotiated salary decreases. Accordingly, we propose that the language in the final document be modified to recognize either salary increases or decreases. We recommend that both final documents be modified to incorporate the term “projected salary changes” instead of the term “projected salary increases”.

**Discount Rate for Projection of Benefit Payments**

Paragraphs 22 thru 25 of ED No. 27 and paragraphs 40 through 43 of ED No 25 propose that the employer and the plan use a blended discount rate in the calculation of the projected benefit payments; an essential ingredient in the calculation of the net pension liability. It is proposed that, to the extent that the plan’s net position is projected to be sufficient to make benefit payments and assets are expected to be invested using a long term investment strategy, the present value of the benefit payments projected to occur in that period should be determined using the long-term expected rate of return on pension plan
investments. We believe the final document should include better guidance as to what constitutes “long-term” when determining the expected rate of return.

**Reporting of Liabilities by Units of the Primary Government**

We believe that the proposed requirement in paragraph 15 of ED No. 27 which would result in component units reporting and accounting for pensions in their standalone financial statements as if they were cost sharing employers, will add an additional level of complexity and result in costs not justified by the value of the incremental information provided. We contend that the provision of such information by the component unit may be conceptually flawed as the exposure draft uses "push-down" accounting that may not be fully justified given the relationship of component units to a primary government. Furthermore, some component units share staff with the primary government and it may be unclear under the proposed language as to which entity should report a pension liability and to what extent. As an alternative, we suggest that more of an inflows / outflows approach be used to establish a reporting requirement for component units in instances where the pension liability for employees of a component unit is unconditionally funded in its entirety by the primary reporting entity. Such an alternative might require a component unit to disclose the fact that it has no pension liability and to name both the pension plan in which its employees participate and the primary reporting entity that provides unconditional funding.

**Illustration 1- Calculation of Discount Rate**

We appreciate the Board providing illustrations to demonstrate the calculation of various items necessary to implement the proposed statements. We believe that Table 3 of Illustration 1 should be expanded to present the calculations for the entire 96 year period used in the illustration. This will assist users of the final standards. If a full illustration is not provided, perhaps the Board could provide this to users in a supplemental form.

We have also provided answers to the questions contained in the Plain Language Supplement that was issued in conjunction with the two exposure drafts. These answers follow.

**Questions for Users about Recognizing the Net Pension Liability**

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

   We strongly agree with GASB’s proposal that governments recognize a net pension liability in their financial statements. We believe that the pension benefit accrues to the employee as services are rendered and becomes irrevocable upon vesting. Therefore a liability should be recognized to the extent that assets have not been set aside and invested to pay the projected benefit payments. This treatment is consistent with the requirements of a liability as defined in Concepts Statement No. 4, paragraph 17.

2. *How would recognizing the net pension liability in the financial statements affect any or all of the following:*

   a. *The 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?*
   c. *Your ability to assess interperiod equity?*
Recognition of the net pension liability will enhance the usefulness of the financial statements. The cost of pension benefits often represents a significant expense of the government and to the extent that a liability accrues for this expense, it should be disclosed. These changes will strengthen and enhance the ability of users to assess interperiod equity as these changes will better match expenses with the correct fiscal period.

Questions for Users about Measuring the Total Pension Liability

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

We agree with GASB’s proposal for calculating the total pension benefit liability. Further, we believe that the discounting method proposed for calculating the unfunded benefit payment amount is appropriate as it provides current period valuation of the estimated future liability payment stream. While we question the accuracy of using an index rate for a 30-year, tax exempt municipal bond rated AA/Aa or higher for all entities, we understand that comparability will be enhanced by having a single rate for all entities to discount this portion of the projected benefit payments.

However, we recommend that GASB require, in the final document, that the employer provide a comparison between the gross, unfunded net benefit payment amount and the discounted unfunded benefit payment amount used in calculating the net pension liability. This comparison can be provided in either the notes to the financial statements or in the Management Discussion and Analysis section. The comparison should disclose the discount rate and term over which the benefit payments were discounted to provide the reader with important information regarding the decisions made by the employer as to contributions into the pension plan.

4. How would those proposals affect any or all of the following:
   a. The 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?
   c. Your ability to assess interperiod equity?

We believe that the proposal would have a very positive impact on the usefulness of the information, improve accountability and provide a better ability to assess interperiod equity. Our overall support for the exposure drafts are stated in our comments to Question 2 (a-c).

Questions for Users about Measuring Pension Expense

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

We agree with the GASSB proposal regarding what factors should be incorporated into the pension expense. We support the proposal that the factors that affect pension expense for current retirees must be
immediately recognized by the employer. This supports the concept of measuring interperiod equity and is a conservative approach to this matter.

6. How would those proposals affect any or all of the following:

   a. The 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?
   c. Your ability to assess interperiod equity?

We believe that the proposal would have a very positive impact on the usefulness of the information, improve accountability and provide a better ability to assess interperiod equity. Our overall support for the exposure drafts are stated in our comments related Question 2 (a-c).

Questions for Users about Governments in Cost-Sharing Plans

7. Do you agree or disagree with the 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 plans should report a liability equal to their long-term proportionate share of the collective net pension liability of the plan. However, the calculation of this liability may be problematic for the plan if multiple employers have several different fiscal reporting periods. We believe that changes should be made to the final document which would allow for various estimates to be used by employers if measurement would be problematic and not cost beneficial.

8. How would recognition of a proportionate net pension liability affect any or all of the following:

   a. The 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?
   c. Your ability to assess interperiod equity?

We believe that the proposal would have a very positive impact on the usefulness of the information, improve accountability and provide a better ability to assess interperiod equity. Our overall support for the exposure drafts are stated in our comments to Question 2 (a-c).
Questions for Users about Notes and RSI

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

We agree with ED No. 27 regarding the content of matters to be disclosed in the notes to the employer’s financial statements and request the notes also disclose the undiscounted amount of the unfunded benefit payments, including all assumptions used to compute the discounted amount. As discussed in our answer to Question 3, we recommend additional disclosures be required regarding the calculation of the unfunded future benefit payment calculation.

We disagree with the exposure draft regarding what is proposed to be included as RSI. ED No. 27, paragraphs 42-43, paragraphs 70-71 and paragraphs 90–91 propose that employers provide information in a series of schedules on various matters for the last 10 fiscal years. We believe the preparation of such information on a retrospective basis will impose an unnecessary burden for the employer preparing the information and increase the cost of the audit. The information being requested as RSI will present some difficulties in development by the employer as plan assumptions and market conditions that existed at the time and forecast to continue changed during the time period covered by the RSI schedules. We suggest that RSI information be limited to several key elements such as the amount of the covered payroll, the required contributions, and the actual contributions made by the employer.

If the information proposed for RSI is considered essential, we suggest that GASB eliminate the proposed RSI requirement and provide language that would either allow for the accumulation of this information (and presentation as RSI) on a cumulative basis until it provides for a six year comparison period. The RSI would be provided for a six year period thereafter. This will provide information to the user regarding trends that can be used to modify actions as opposed to information that cannot be used to take action.

10. How would these disclosures and RSI affect any or all of the following:

   a. The 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?
   c. Your ability to assess interperiod equity

We believe the notes disclosures will provide useful information. We also recommend that the Board require additional disclosures regarding the amount of unfunded future benefit payments at the end of the fiscal period. This disclosure should include a comparison of the full, non-discounted amount of future benefit payments, the discounted unfunded future benefit payment amount used in the calculation of the net pension liability and the discount rate and term used for the calculation.
We think that the information GASB has proposed be included as RSI is unnecessary. The principal basis for the development of this exposure draft is to provide the user with information on the future obligations of the government, the cost of these obligations and the amount that has not been funded with assets, invested by a trustee. Providing extensive historical information does not enhance the effectiveness of the information provided to the users. We suggest that RSI be limited to some basic information on the present conditions as discussed in our answer to question No. 9.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. A majority of the FMSB members approved of the issuance of this letter of comments. If there are any questions regarding the comments in this letter, please contact Steven E. Sossei, CPA, and AGA’s staff liaison for the FMSB, at ssossei@agacgfm.org or at 703-684-6931, extension 307.

Sincerely,

Eric S. Berman, CPA, Chair
AGA Financial Management Standards Board

cc: Richard O. Bunce, Jr., CGFM, CPA
AGA National President
Association of Government Accountants
Financial Management Standards Board

July 2011 – June 2012

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Steven E. Sossei, Staff Liaison, AGA
Good morning Mr. Chairman and Members of the Governmental Accounting Standards Board:

I am pleased to offer testimony on behalf of the Financial Management Standards Board and the membership of the Association of Government Accountants on our views to the exposure drafts *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25* and *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. My testimony is a synopsis of our comments and some further thoughts.

As you have heard in previous hearings and in comment letters and in testimony this morning from my esteemed colleagues, the importance of these exposure drafts cannot be underestimated. Our committee had a very lengthy, spirited debate in providing our written comments to the Board. Overall, we strongly support the underlying premise of the exposure drafts. We believe that by recording a net pension liability, financial reporting and transparency is improved. Our committee firmly believes that the pension obligation to a vested employee is generally irrevocable with little or no discretion for
avoidance. This position is consistent with our views reported in 2010.

There are a number of areas that we believe should be clarified in the final documents:

- Because of continuing furloughs, there could be a possibility of salary decreases. These projected decreases, whether short term or permanent, should be accounted for in the projection of benefit payments.

- The definition of “long-term” should be discussed with regard to discount rate projections. We understand that the term “long-term” for many plans will differ based on demographics, but some principles should be established. Is it an average employee’s employment cycle? Is it a generation of a general purpose government’s bond payments? Is it an economic cycle? Some basic guidelines should be established to enhance comparability and reduce “gamesmanship.”

- The discount rate calculation itself was very difficult for some of our members to follow. Should the method be retained, even though it may require presentation of many lines of data, the presentation of all years may enhance understanding. Alternatively, we offer moving more toward a weighted average scenario - \([(\text{long term rate of return} \times \text{percentage funded}) \times (\text{AA bond index yield} \times \text{percentage unfunded})]\). Using a simpler method may help many unsophisticated governments to understand the yield calculation and may not be materially different than the proposed method.

- Separate reporting by component units, functions of government or agencies that pay for their share of post-employment benefit costs through a charge mechanism from a primary government may be a challenge. Understandably, the Board may not wish to address the “push-down” accounting effects of this situation, but it could result in these entities having no share of liability on their financial statements, when the economic substance of the transaction may point toward some liability, especially in the case of highly organized entities such as transit authorities or institutions of higher education that do not have separate plans.

- The RSI schedules are a bit cumbersome, especially in the light of new audit procedures. We are not sure of the decision usefulness of ten years of schedules as RSI rather than in the statistical section.
Further, it would appear that if these were RSI, unless prospective implementation is allowed, then a restatement may occur for all ten years to align with the new standards. This may have a large cost for minimal benefit.

Ultimately, the success of the implementation of these proposed standards will be measured on the level of understanding by unsophisticated stakeholders. The vast majority of the implementation process will definitely be in the form of communication and understanding. There will be a host of downstream effects to the implementation that our committee has brainstormed about:

1. *First, what will be the audit implications on the implementation?* For many governments, this will be the largest number on the statement of position and it will be a liability. Will this generate a going concern? Have the rating agencies been consulted? Will it have to be adjusted for in ratio analysis? And what sort of reliance can we place on information coming from agent and cost sharing plans? Are governments going to have to have Service Organization Control reports issued? These are not per se the Board’s concern, but it is something that is very real and potential costly prohibitive.

2. *Second, implementation will have to entail different levels of government to work together more so than ever before.* Especially when dealing with agent and cost sharing multiple employer plans, timing will be vital. Plans may not have the luxury of 3, 4 or even 6 month reporting cycles anymore as their member-governments will have to access the information in enough time so that their audits will be completed on a timely basis. Given the push to have more timely, transparent and relevant reporting, especially should the SEC get involved, this is a very real issue. How much delay in presenting current data is to be permitted before qualified opinions will be required?

3. *Finally, Implementation is Already Behind.* Many plans and governments have already started planning for 2013. The proposed effective date of periods beginning on or after June 15, 2012 will be a challenge for many governments. Though there may be other organizations that may discuss the implementation date, we ask the Board for consideration of this matter. Indeed, there will be no good
time to implement, but given the potential downstream effects for providing data from plans to governments to component units, there may be those who call for a delay.

I invite the Board’s questions.

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