Dear Sir/Madam,

Please accept the comments below as the joint response of Kentucky Head Start Association (KHSA) and Community Action Kentucky (CAK).

KHSA has 32 grantee members with 3,497 employees serving 17,673 low income children and their families in all 120 counties of the Commonwealth of Kentucky. Community Action Kentucky (CAK) is the umbrella organization with twenty-three (23) Community Action Agencies covering every county in Kentucky. [Note, one member, Community Action Council (Lexington, KY), is not a member of the state’s retirement system and is not party to these Comments]. CAK and the CAA’s have approximately 5,900 employees statewide. CAK served 250,584 individuals for LIHEAP last year, provided 306,248 individuals with crisis services, 4549 families with weatherization services and 190,683 persons with Community Services Block Grant programs. State and locally funded programs through the agencies served another 100,000 or more individuals. CAK aids almost a million Kentucky citizens a year.

On July 11, 2011, the Governmental Accounting Standards Board (GASB) issued Exposure Drafts (ED) of the proposed amended Statement Nos. 25 and 27 covering the Financial Reporting for Pension Plans (No. 25) and Accounting for Pensions by State and Local Governmental Employers (No. 27). The following Comments apply to that draft.
1. **KHSA AND CAK DISAGREE WITH THE PROPOSAL FOR THE FOLLOWING REASONS:**

The state’s pension plans, Kentucky Retirement Systems and County Employees Retirement Systems are cost-sharing multi-employer plans that operate jointly. The unfunded sum of the combined pension plan is $2.9 billion and the unfunded sum of the combined insurance plan is $1.9 billion. The liability for each entity’s share of those pension plans far exceeds the minimal positive balance reflected on the accounting statements of KHSA and CAK members.

The *Exposure Draft Supplement*, June 27, 2011, “Proposed Statement of the Governmental Accounting Standards Board: Plain-Language Supplement” states that the Proposal “relate(s) solely to accounting and financial reporting...” Id., p. 1. The GASB suggests that where the funding for a pension plan is a binding obligation on a government, that obligation “should be recognized in the financial statements rather than disclosed in the notes to financial statements.” Id., p. 2. The GASB is considering the government as the “employer” which must list the “liability” on their balance sheet. Id., p. 3. In cases where there are multiple employers which share a government pension plan, the GASB proposes that each individual employer must report a net pension liability based on its proportion of the collective net pension liability of all the employers which participate. Id., pp. 10; 14. In fact, under the proposal, the books are less correct as the Community Action Agencies and Head Start providers will list a debt that they are not actually liable for, thereby creating an inaccurate negative balance sheet.

By way of background with respect to the political and statutory subdivisions of government in the Commonwealth of Kentucky, certain entities, including but not limited to the Community Action Agencies and most Head Start educational providers, are by Kentucky statute “special districts” which operate as quasi-governmental entities whose employees take part in the Kentucky Retirement Systems (KRS) pension plan and are deemed to be members of the “County Employees Retirement System within KRS. Kentucky Revised Statutes 273.410(2); 922 Kentucky Administrative Regulation 6:010.

Under Kentucky’s statutory scheme, none of the individual employers within KRS is separately liable for the unfunded pension liabilities (net pension liability) of KRS. Rather, Kentucky statute provides that KRS has an inviolable contract the employee members of KRS which requires KRS to pay the retirement obligations of retired employees as they come due. See: Kentucky Revised Statute 61.692 “Benefits not to be reduced or impaired”, which holds:

> It is hereby declared that in consideration of the contributions by the members and in further consideration of benefits received by the state from the member's employment, KRS 61.510 to 61.705 shall, except as provided in KRS 6.696 effective September 16, 1993, constitute an inviolable contract of the Commonwealth, and the benefits provided therein shall, except as provided in KRS 6.696, not be subject to reduction or impairment by alteration, amendment, or repeal.
Identical language with regard to county employees is found in Kentucky Revised Statute 78.852. See also: *Jones v. Board of Trustees of Kentucky Retirement Systems*, 910 S.W.2d 710, 713 (Ky.1995).

Moreover, the Kentucky General Assembly has the sole authority to set employer contribution rates for state, county and state police employers (the three component parts of KRS) throughout Kentucky. Once an employer has made all legislatively-mandated contributions to KRS on behalf of its employees, that employer has no further obligation to KRS or for the payment of KRS’s net pension liability. Kentucky Revised Statute 61.595. Indeed, in the event of a default in pension payments, the retired employees of X entity (a member of KRS) have no legal remedy against X for their future pension payments when X has made the full extent of its current contributions at the end of each payroll period. Rather, the sole remedy for those employees is against KRS.

Given that Kentucky law insulates individual participating employers liability to the legislatively-mandated level of current payroll contributions, KHSA and CAK respectfully submit that the GASB’s proposal that each individual employer must report a net pension liability based on its proportion of the collective net pension liability of all the employers which participate does not accomplish any of the following:

- Providing useful information in analyzing a given participating employer’s financial standing or in making decisions with respect to such a participating employer,
- Assessing a participating employer’s accountability, or
- Helping to determine a participating employer’s interperiod equity (the raising of sufficient resources to cover its costs).

**Effect of Proposed Reporting on KHSA and CAK members**

KHSA has 32 federally-funded grantee members with 3,497 employees serving 17,673 low income children and their families in all 120 counties of the Commonwealth of Kentucky.

Community Action Kentucky (CAK) is the umbrella organization with twenty three (23) Community Action Agencies covering every county in Kentucky. CAK and the CAA’s have approximately 5,900 employees statewide. CAK served 250,584 individuals for LIHEAP last year, provided 306,248 individuals with crisis services, 4549 families with weatherization services and 190,683 persons with Community Services Block Grant programs. State and locally funded programs through the agencies served another 100,000 or more individuals. CAK aids almost a million of Kentucky’s most vulnerable citizens a year. Disrupting that service provision would have a disastrous effect on the state’s health and welfare.

The member agencies of KHSA and CAK are funded in large measure by federal, state and private grants. Many of these grants have grantee solvency requirements which require submission of audited financial statements to the grantor. A key component of such grant funding is
that the entity prove that it is financially stable and can effectively provide the services funded by the grant.

For example, the audited financial statements required by OMB Circular A-133 are used to determine eligibility for competitive continued funding as well as eligibility for future grants. The GASB’s proposal would require these grantees to list a substantial net pension liability on the balance sheets. The size of the liability, in many instances, would cause the balance sheet to show a negative equity which, in many funding instances, will trigger a termination of the grant or in the case of Head Start grantees, will trigger a recompetition of their grant due solely to the negative equity arising from the net pension liability.

The result? Kentucky’s Community Action Agencies and Head Start providers could lose all or substantial amounts of current grant funding to serve thousands of needy citizens in the state.

Appendix B to the Proposal, “Basis for Conclusions and Alternative View” indicates that the potential devastating effect the action would have on entities such as the Community Action Agencies and Head Start service providers in Kentucky was not one of the items considered. See: Appendix B, pp. 54-55.

Appendix B notes, at para. 126, p. 56, the importance of ensuring that financial report users be able to assess interperiod equity using the data provided pursuant to the proposal. That goal cannot be met by imposing the burden of reporting on the Community Action Agencies and Head Start service providers. Those small entities, some with only a few employees, will have no appreciable effect on the overall pension wellbeing, but the listing of the net pension liability in their financial statements will have a devastating effect on their ability to secure and maintain grant funding to serve the needy citizens of the Commonwealth.

2. RECOGNIZING THE NET PENSION LIABILITY IN THE FINANCIAL STATEMENTS WOULD ADVERSELY AFFECT GRANT FUNDING OPPORTUNITIES AND THE PROVISION OF NECESSARY SERVICES:

a) The information is not useful to analysis and decision-making in terms of the specific services offered by the entities commenting.

GASB demands that information provided on balance sheets accurately reflect the liabilities of the reporting entity. See: Statement 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards (4/16/09). This proposal did not establish new accounting standards; it merely clarified why certain matters should be reported for the purpose of clarity and consistency. That purpose is not served by the pending proposal. The actions recommended by GASB would actually decrease the accuracy and clarity of the balance sheets for CAK and KHSA.

GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets, (06/07), demanded that assets not be listed until they are truly an asset of the business. A similar rationale should be used with liabilities of an entity. Listing a liability that is not the responsibility
of that entity or is not going to be the responsibility of the entity in the future renders the balance sheet confusing and incapable of educated analysis and review.

Kentucky Employees Retirement System was established by state law. Kentucky Revised Statute 61.515. Under the clear statement of the law, Community Action Kentucky and Head Start service providers have no control over operation of the KRS pension fund. Further, the contract for pension payments is an inviolable contract between the state government and the employee, not the Community Action Agency or Head Start service provider and the employee.

While these entities are accountable to the various funding authorities for the programs they offer, that accountability is properly based solely on the performance of the entity in operating the grant programs and should not reflect any pension fund liability due to operation of the state’s pension fund which is funded by mandate of the Kentucky General Assembly, not by decisions made by CAK or KHSA agencies.

This is particularly so with regard to benefits applicable to retired employees of a Community Action Agency or Head Start service provider. Kentucky Revised Statute 61.595 “Retirement Allowance” indicates that once an employee begins to receive payments following retirement, the employer has no further involvement. Those rights have vested in the employee and must be fulfilled by the Kentucky Retirement Systems. Id.

b) Government accountability is not affected by listing the information on the balance sheets of CAK or KHSA member agencies.

GASB recognizes the need for reporting funding in a manner that accurately reflects an entities’ actual financial health. See: GASB Summary of Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions (Issued 02/09), The requirements in this Statement will improve financial reporting by providing fund balance categories and classifications that will be more easily understood.

The operation and management of the KRS Board of Directors is exclusive to that entity. Kentucky Revised Statute 61.645. The Board, under the framework provided by the Kentucky General Assembly, controls use and distribution of KRS funds. Kentucky Revised Statute 61.652. Participation and membership are fixed by the General Assembly. KRS 61.520. Employer contributions are mandated by Kentucky Revised Statute 61.565 in a defined actuarial percentage.

Recognition of deferred inflow is accepted and a note on an accounting sheet is used to show the inflow, rather than listing the entire potential sum of the contract as revenue. See: GASB Statement 60, March 2011. The reason for the footnote listing and the recommendation that this sum not be listed as revenue immediately is to provide clarity and accuracy to the reviewer. Similarly, listing a debit that the company was not fully responsible for or did not have control over would create a lack of clarity and accuracy in the entities’ balance sheet.

If the KHSA and CAK are required to list the liability of the Kentucky Employees Retirement Systems and County Employees Retirement Systems on the KHSA and CAK balance sheets, the bal-
 ance sheet of the Kentucky Retirement Systems will look artificially healthy while balance sheets of the member entities look artificially insolvent or negative. This is not the stated purpose of the GASB proposal and will cause an unprecedented potential harm to the entities and the needy citizens they serve.

c) **Assessment of interperiod equity can be made without inclusion of the net pension liability on the balance sheets of CAK and KHSA member agencies**

Interperiod equity is a government's obligation to disclose whether current-year revenues were sufficient to pay for current-year benefits and whether future taxpayers will be required to assume burdens for services previously provided. The Community Action Agencies and Head Start providers are not properly a part of that evaluation with regard to the state’s pension fund as their liability is limited to the amounts mandated by the General Assembly from their current payroll.

d) **Request for an exception**

GASB recognizes that under some circumstances, exceptions to recommended practices are appropriate for certain entities. See: Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (Issued 6/04) provides a simplified alternative measurement method for small employers or those not fully liable for the cost of the program or not the end receiver of the benefits. Such an alternative reporting method is desired for the uniquely situated commentators here.

**SPECIFIC REQUEST:** The quasi-state entities, Community Action Agencies and Head Start providers request an exception to the GASB proposal. In the alternative, Community Action Agencies and Head Start providers ask for specific language in the proposal allowing them to list the Kentucky Retirement Systems liability as a footnote based on the inviolable contract between the Commonwealth and the employees and the fact that state law reflects the lack of any future responsibility of the entities for employees who are currently retired or disabled. In the absence of such permission, the request is made that GASB propose a five year “phase in” period for the Community Action Agencies and Head Start providers, allowing them time to fully apprise all funding entities and all clients served of the GASB recommendations, so that confidence in the ability of the entities to provide services under a grant is maintained as the entities transition to listing the liability on the balance sheet.

Respectfully submitted,

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