September 26, 2019

Mr. David Bean, Director of Research and Technical Activities
Project Number 3-33
Governmental Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Submitted via email to director@gasb.org

Dear Mr. Bean:

Thank you for the opportunity to provide these comments regarding the proposed statement of the Governmental Accounting Standards Board (GASB, the Board), Internal Revenue Code Section 457 Deferred Compensation Plans That Meet the Definition of a Pension Plan and Supersession of GASB Statement 32 (ED, the ED). I commended the Board for recognizing the use and operationalization of Section 457 plans has changed since the issuance of GASB Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans – a rescission of GASB Statement No. 2 and an amendment of GASB Statement No. 31, in 1997. In addition, I appreciate this opportunity to respond to the ED. My comments reflect my views as a former government finance officer (who was instrumental in establishing and administering Section 457 plans) and a current academician responsible for teaching undergraduate and graduate level courses in governmental accounting and auditing.

General Comments

I am confused as to why the ED only addresses deferred compensation plans under Internal Revenue Code (IRC) Section 457 when governments offer other deferred compensation arrangements to their employees. For example, a number of school systems provide deferred compensation plans under IRC Section 403 (b)\(^1\). Additionally, a number of governments (California, Colorado, Georgia, North Carolina and Texas to name a few) offer deferred compensation plans recognized under IRC Section 401 (k). Other governments offer a hybrid type of plan combining elements of deferred compensation plans and defined benefit/contribution plans. If the Board proceeds with approving the ED as a final standard, I would ask the Board to consider expanding the scope of the proposed standard to include other deferred compensation arrangements allowed under the IRC. This would provide consistency in reporting deferred compensation plans among governments and thus avoid diversity in practice.

Specific Comments

Paragraph 4

It is unclear to me, from paragraph 4 of the ED, which Section 457 plans the Board intends to be accounted for and reported as pension plans. I believe the guidance in paragraph B6 should be included in the body of the final standard (early in the standard or in paragraph 4) as many financial statement preparers and users may not read the Basis for Conclusions section of this (or any) standard. I believe this

\(^1\) Initially, these plans offered individual purchased annuity contracts administered through insurance companies to plan participants. Such annuities are tax sheltered because they are purchased under a salary reduction agreement (Internal Revenue Code (IRC) 403 (b)(1)(E)). Today, these plans now allow, under IRC Section 403 (b), individual pre-tax deferred compensation accounts for plan participants. To be a qualified plan, IRC Section 403 (b) requires the individual accounts to be custodial accounts invested in mutual funds.
would reduce the potential for diversity in practice or from improper application of the requirements of the final standard.

Paragraph 4 and Paragraph B6 – Section 457 Plans as Pension Plans

I disagree with the Board’s position in paragraph B6 that will require Section 457 plans, to which employers contribute, to be accounted for and reported as a pension plan. Section 457 plans by federal law are deferred compensation plans. IRC Section 415(c)(3)(D)(ii) states a participant’s compensation “shall include”... “any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of section 125, 132(f)(4), or 457.” As such, employer and employee contributions to Section 457 plans are subject to the Federal Insurance Contributions Act and are reported on federal form W-2, Wage and Tax Statement, in Box 12. Therefore, the character of the employer contributions is “compensation” for services currently rendered to the employer and not a “benefit” to the participant.

Under 1.457-2(e)(3) of the Internal Revenue Service Regulations, employer contributions which vest on a delayed basis and are subject to substantial risk of forfeiture (until fully vested) are considered deferred compensation in the year the employee vests in the employer contributions. Any employer contributions in which employees do not vest must remain in the Section 457 plan. The IRC does not allow distribution of excess deferrals in a Section 457 in advance of the normal distribution events enumerated in Section 457 (d). This regulation appears to also support the position that employer contributions to Section 457 plans are deferred compensation to the plan participant rather than “benefits” such as those resulting from employer contributions to a defined benefit pension plan.

I believe use of the Board’s definition of “pension” (which refers to “retirement income” and certain postemployment benefits other than retirement income) in the context of Section 457 plans will create confusion among financial statement preparers and users. Additionally, use of the term “pension” is incorrect because Section 457 plans are deferred compensation plans whereby plan participants simply receive compensation they earned in prior years of service on a pre-tax basis. The fact many participants chose to take these payments upon retirement does not negate the legal form of Section 457 plans. Section 457 requires plan participants to begin taking distributions no later than age 70½. Since Americans are retiring later than previous generations, it is possible a plan participant could still be an active employee at age 70½. Therefore, plan distributions would not represent “retirement income” and would not meet the definition of a pension meaning the Section 457 plan would not meet the definition of a pension plan.

For these reasons stated in this section I do not believe it is appropriate to require governments to account for a Section 457 plan as a “pension plan”.

Paragraph 4 – Section 457 Plans as Fiduciary Activities

As noted in my comments above, I do not believe Section 457 plans are pension plans and therefore would need to be considered using the requirements of paragraph 11 of Statement No. 84, Fiduciary Activities. Under IRC Section 457 (g), plans maintained by eligible employers must hold all assets and

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2 Section 457(e)(6) requires that compensation deferred under a plan be taken into account at its present value in the plan year in which deferred. As such, an employer cannot use unreasonable actuarial assumptions or interest rates to calculate the present value of benefits.
income of the plan in trust\(^3\) for the exclusive benefit of participants and their beneficiaries. The government sponsor has no control over the assets in a Section 457 plan as funds are held in individual custodial accounts and invested at the direction of the plan participant. Also, once employer and employee contributions are made to a Section 457 plan, they cannot be accessed by the employee except for normal distribution events. A sponsoring government simply identifies the entity to hold the assets and may in some circumstances identify the investment products from which plan participants may choose their investment vehicles. The result is the Section 457 plan does not meet the criteria in paragraph 11a in Statement No. 84. Since Section 457 plan assets are for the benefit of a government’s employees, Section 457 plans do not meet the criteria in paragraph 11c(3) either.

Additionally, I do not believe the assets of a Section 457 plan meet the definition of an asset as they do not have any present service capacity the government presently controls. Likewise, amounts held for plan participants are held in custodial accounts and do not meet the definition of a liability because resources belonging to the individual participant are used to satisfy the present obligation to the respective plan participant.

Paragraph 5 and Paragraph B5

As noted previously in my comments, I do not believe Section 457 plans meet the definition of a pension plan nor do I think the amounts held in such plans meet the definition of an asset or liability. However, if the Board concludes the ED should be issued as a final standard I would ask the Board to reconsider the requirement to measure plan investments using fair value.

Currently, statements for Section 457 plans are often focused on a calendar year basis rather than the sponsoring government’s fiscal year. The requirement for plan investments to be measured at fair value at fiscal year-end versus calendar year-end could be problematic and costly to the sponsoring government and/or plan participants. Additionally, based on my anecdotal experience, administrators of Section 457 plans may not be aware of the requirements in Statement No. 72, *Fair Value Measurement and Application*. This may result in a lengthy period of time needed to reprogram their systems and the cost of such may be passed on to the sponsoring government or plan participant.

**Other Concerns**

As noted throughout this comment letter, I do not believe Section 457 plans meet the definition of a pension plan. However, if the Board concludes the ED should be issued as a final standard I would ask the Board to consider the following potential issues.

1. Section 457 plans may be offered as multiple employer plans with data provided for individual plan participants similar to an agent-multiple plan. In such cases would all of the disclosures required of agent-multiple pension plans be required for Section 457 plans? I believe the cost of providing such additional and comprehensive disclosures would exceed the benefit of the information.

2. In Section 457 plans with employer contributions, does the Board anticipate an actuarial valuation would be required to determine the portion of the unvested portions of the employer contributions? If so, this would likely be a significant initial and recurring cost for which the sponsoring government and/or plan participants would be responsible. Such actuarial calculations would likely be in addition to the present value calculations required under Section 457.

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\(^3\) Under IRC Section 457 (g)(3) custodial accounts and contracts are required to be treated as trusts. IRC Section 457 (g)(2)(B) mandates the amounts in the trust be includible in the gross income of participants and beneficiaries.
**Proposed Effective Date**

The proposed effective date is extremely aggressive. Governments have dealt with the retrospective implementation of a number of complex standards (pensions, other post-employment benefits, and fiduciary activities) over the last several years. Currently governments are preparing to implement the requirements of Statement No. 87 on a retrospective basis and it is anticipated this is likely to require a significant commitment of capital and human resources for many governments. The proposed accounting and financial reporting changes relating to Section 457 plans are also likely to require lead significant time to implement properly and still issue financial statements on a timely basis. For example, Section 457 plan administrators will likely need significant time to determine what changes will need to be made to their systems to report plan assets at fair value. For these reasons, I think the proposed effective date should be no earlier than for fiscal years beginning after December 15, 2022.

**Concluding Remarks**

As always, thank you for the opportunity to respond to this due process document. Should you have any questions regarding the above, please contact me at (321) 277-1536 or lkmdennis@gmail.com.

Sincerely,

Lynda M. Dennis, CPA, CGFO, PhD