January 31, 2017

Via Email

Director of Research and Technical Activities
Project No. 24-16ED
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
director@gasb.org

Re: GASB Exposure Draft: Implementation Guide No. 201X-Y,
Implementation Guidance Update-201X, Project No. 24-16ED

Dear Sir or Madam:

This letter concerns the above Exposure Draft, specifically Q&As 4.4–4.11, which relate to the accounting treatment of amounts set aside in a supplemental trust to fund public agencies’ employer contributions to pension plans.

A. Introduction

We represent numerous public-agency employers in California that participate in CalPERS, CalSTRS, or other multiple-employer pension plans (collectively, “CA Pension Plans”). Under the tax laws, benefits under a CA Pension Plan must be paid from a trust described under section 401(a) of the Internal Revenue Code (i.e., a 401(a) trust). Accordingly, every CA Pension Plan maintains a 401(a) trust to hold the plan’s assets.

Many of our public-agency clients have adopted separate, stand-alone trusts to fund the agency’s contributions to the CA Pension Plan in which it participates. Assets in these trusts cannot be used for any other purpose. The trusts are designed to be tax exempt under section

1 CalPERS is the California Public Employees’ Retirement System. CalSTRS is the California State Teachers’ Retirement System. CalPERS and CalSTRS are the two largest public retirement plans in the U.S.A.
January 31, 2017
Page 2

115 of the Internal Revenue Code (i.e., a 115 trust). Q&As 4.4–4.11 of the Exposure Draft address stand-alone trusts of this type, referring to them as “Trust B.” In sum, the Exposure Draft concludes that an employer’s financial reports must report Trust B assets not as pension assets, but as employer assets.

For the reasons discussed below, we request that GASB modify the Exposure Draft or, alternatively, amend GASB Statement No. 74, to permit public-agency employers to report Trust B assets as pension assets.

B. Exposure Draft

We disagree with GASB’s interpretations in Q&A’s 4.4–4.11 of the Exposure Draft for the following reasons:

- Q&A 4.4 sets out two core rationales for GASB’s interpretations in Q&As 4.4–4.11. The first is that Trust B assets “will benefit the employer through reduced future cash flow demands on that employer’s general fund resources . . .” This reasoning is flawed. All contributions to Trust A likewise reduce an employer’s cash-flow demands, yet the GASB rules unequivocally permit these contributions to be reported as pension assets.

  GASB might reply that contributions to Trust A and Trust B differ from one another because contributions to the former are mandatory, while contributions to the latter are usually discretionary. It’s correct that every CA Pension Plan requires that participating employers make periodic contributions to the plan’s 401(a) trust (i.e., Trust A). Yet some of those plans (including CalPERS) also permit employers to make additional discretionary contributions to Trust A—when made, these contributions effectively lower the employer’s future contributions and, by extension, the demands on the employer’s future cash flow. Yet under the GASB rules, additional contributions to Trust A would be recognized as pension assets, not employer assets. The same treatment should apply to contributions to Trust B.

- The second rationale for GASB’s interpretations, according to Q&A 4.4, is that “benefit payments can be made to plan members only through Trust A, and Trust A cannot directly access the assets of Trust B.” This reasoning also is flawed:

  - It’s correct that Trust B assets cannot be used to pay benefits under the relevant pension plan. But as described in Q&As 4.4–4.11, Trust B assets may be used for only one purpose—to fund the employer’s required contributions to Trust A. In turn, Trust A assets may be used only to pay benefits under the plan. Thus, connecting the dots, Trust B assets will
ultimately be used only to pay plan benefits. Put another way, Trust B assets are dedicated to providing benefits under the plan in accordance with GASB Statement No. 74, paragraph 3(b).

- It’s also correct that Trust A cannot access Trust B assets. Also, in September 2016, GASB officials met to discuss the Exposure Draft. Explaining the rationale for the interpretations, the officials noted that Trust A may not even be aware of Trust B’s existence. This comment also is correct. Accordingly, we agree that the Exposure Draft’s interpretations should apply to the plan’s financial reports—that is, the plan’s financial reports should recognize Trust A assets, but not Trust B assets. The interpretations, however, extrapolate this conclusion too broadly, stating that the employer’s financial reports cannot recognize Trust B assets. Unlike Trust A, however, the employer can access Trust B assets to make contributions to Trust A; and the employer is aware of Trust B’s existence.

- At the September meeting, GASB officials also seemed to indicate that another possible rationale for the interpretations is that the employer’s primary “intent” in making contributions to Trust A is to stabilize the employer’s budget. But in other similar contexts, the employer’s intent is irrelevant for GASB purposes. For instance, when an employer makes required or discretionary contributions to Trust A, the employer could intend that those contributions reduce its future contributions, thereby improving cash flow. Yet the GASB rules don’t consider intent in that context. Likewise, employer intent shouldn’t affect the accounting treatment of contributions to Trust B.

- An employer generally can use employer assets for any permitted purpose. By contrast, an employer’s use of Trust B assets is restricted to a singular purpose: contributions to Trust A. Reporting Trust B assets as employer assets is not only misleading, but also could be construed as misrepresentation.

Therefore, we respectfully request that GASB modify its interpretations to permit employers to recognize Trust B assets as pension assets for accounting purposes.

C. GASB Statement 74, Paragraph 3

Alternatively, we request that GASB amend GASB Statement No. 74, paragraph 3, to achieve the same result. One possible path would be an amendment clarifying that as long as assets held in a 115 trust are dedicated to making contributions to a 401(a) trust, the 115 trust assets will be treated as providing pension benefits to plan participants.
D. Public Policy

GASB’s interpretations might have the effect of discouraging some public agencies from adopting 115 trusts to fund pension obligations. This is counter to sound public policy, for several reasons:

- In recent years, required employer-contribution rates to most CA Pension Plans have steadily increased. The increases strain already limited public resources. And according to recent reports, the trend is likely to continue. Setting aside funds in a 115 trust whose assets are dedicated to funding employer pension contributions enables employers to ensure they have sufficient funds to make required pension contributions, thereby meeting their commitment to provide pension benefits.

- Under the federal tax laws, only 401(a) trusts may pay benefits owed under pension plans. California law requires that benefits provided by CA Pension Plans be paid from the plan’s own 401(a) trust, effectively forbidding participating employers from adopting separate 401(a) trusts to pay plan benefits. Thus any agency that wishes to set aside moneys in a separate trust for its pension obligations has but one recourse: establish a 115 trust or other non-401(a) trust (i.e., Trust B) that funds employer contributions to the 401(a) trust (Trust A).

  Furthermore, CalSTRS and certain other CA Pension Plans don’t permit participating employers to contribute more than the required employer contribution amount (which is established by the plan or by statute) to the plan’s 401(a) trust. For example, assume that the plan’s required employer contribution amount is less than the actuarially determined contribution. If the employer wishes to contribute the higher ADC amount to a trust, its only recourse would be through Trust B.

- CA Pension Plans have plenary authority over the investment of funds in their 401(a) trust. Consequently, participating employers are unable to direct the investment of their allocable assets under the plans. By contrast, an employer can retain investment control of assets in its 115 trust. This control enables the employer to tailor investment strategies appropriate to its employee demographics and risk tolerance, a valuable tool for employers whose employee demographics and risk tolerance differ from the mean.
For these and other reasons, GASB should seek to encourage use of Trust B type trusts. Changing the interpretations or amending GASB Statement No. 74 as requested above would have this effect.

* * *

Thank you for considering our comments. If you have any questions, please contact me at (858) 509-4030, marcus.wu@pillsburylaw.com.

Sincerely,

Marcus Wu