Letter of Comment No. 103
File Reference 34-PV
Date Received 9-17-10

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September 17, 2010

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To Whom It May Concern:

The American Federation of State, County and Municipal Employees (AFSCME) is the nation's largest public employee labor union, representing 1.6 million employees who work primarily in local and state government and in the health care industry. We are pleased to provide the Governmental Accounting Standards Board (GASB) with our comments on the Preliminary Views related to Pension Accounting and Financial Reporting by Employers. We have a strong interest in maintaining a sustainable, well-functioning public pension system and transparency in public finance. In addition, our organization has members and leaders at all levels that are end users of financial reporting on public sector pensions and governments on a regular basis.

The current GASB standards governing the reporting of pension obligations have worked exceptionally well. The rules provide users with appropriate and reliable information that facilitates accurate analysis of the financial conditions of a public pension plan and its sponsoring governmental employer. This information enables informed public policy decisions. We believe that much of the success of the current standards stems from the consistency of the rules for both funding and accounting purposes, and we would urge GASB to proceed with caution with changes which would de-link these closely related functions.

**ISSUE 1 — AN EMPLOYER'S OBLIGATION TO ITS EMPLOYEES FOR DEFINED PENSION BENEFITS**

AFSCME agrees with the GASB view expressed in Chapter 2:

*"that for accounting and financial reporting purposes, an employer has an obligation to its employees for pension benefits by virtue of the employment exchange, and this obligation is not satisfied until the defined pension benefits have been paid to the employees or their beneficiaries when due."*

**ISSUE 2 — LIABILITY RECOGNITION BY A SOLE OR AGENT EMPLOYER**

To determine whether or not a liability should be recognized on the balance sheet, the preliminary views document discusses the requirements that must be met:

*That is, in order to be recognized, an item **should be both an element of financial statements and measurable with sufficient reliability** for that purpose.*

The PV notes that "sufficient reliability" should "faithfully represents what it purports to represent, is comprehensive, and is not misleading."

From our perspective, the proposed reporting of the Net Pension Liability (as defined in the preliminary views document) does not meet the "sufficient reliability" standard. For example, the New York Employees' Retirement System (NYERS) would have reported a negative unfunded obligation (or asset) of $8.7 billion as of April 1, 2008. The NYERS then experienced a 1-year asset return of -26.4% (market value return as of March 31, 2009). With assets of $129 billion at the beginning of the year, this implies losses of approximately $34 billion. However, in the very next year, the plan assets showed an investment return of 25.9%. Because of the extreme volatility in investment markets, the Net Pension Liability (based upon a market value of assets) is not a "sufficiently reliable" representation of the funding status of the pension fund. The financial statements produced at the peaks and troughs of investment performance would be very misleading and would not provide useful information for end users.

In addition, the inclusion of unfunded/overfunded pension obligations on the balance sheet would likely create a stronger boom/bust cycle, where policymakers would have an overly optimistic view of the entities' financial health when pension investment returns are robust and overly pessimistic view when investments retrench, especially since strong or weak investment returns often correlate with increased or depressed government revenue collection.

Also, the magnitude of pension obligations could overwhelm an analysis of many entities' balance sheets. Pension plans accumulate large pools of assets, which could overshadow other important measures shown on the balance sheet. Thus, an overall assessment of the financial condition of a reporting entity would be based primarily on the funding status of the pension fund(s) which, in turn, are subject to a volatile investment environment. We believe this would do more to cloud end users' understanding than enhance it, especially when an overfunded pension plan distorts the overall asset to overall liability ratio.

Finally, information on a plan's funded status is already available in the financial statements. Thus, users who value and seek the information may find it within the financial report.

## Issue 3 — MEASUREMENT OF THE NET PENSION LIABILITY BY A SOLE OR AGENT EMPLOYER

### Net Pension Liability

AFSCME does not support replacing the Annual Required Contribution (ARC), and the practice of reporting the shortfall/excess funding of the ARC, with a new metric – the Net Pension Liability. The current standard gives clear information about the actions of policymakers regarding funding their pension plan at the recommended levels while the proposed measure is not nearly as useful.

The proposal to add the Net Pension Liability to the balance sheet, which appears to be based in part on the market value of assets, introduces an enormous amount of volatility to governmental accounting. In addition, the proposal would de-link pension funding from pension accounting. The introduction of additional volatility and differing measures will lead to confusion and possible adverse policy decisions at both the peaks and troughs of the investment performance of the pension fund.

Accountability will also be impaired, since the Net Pension Liability will often be either too large to fund or negative (which would imply no contributions are necessary). In contrast, the ARC presents a standard for a long-term funding plan which should be paid each year – and serves as a clear metric to hold policymakers accountable. The ARC, and a plan sponsor's commitment to funding it, is a far more useful measurement of the financial ability of the employer to sustain its pension plan than the overall NPL. End users in the financial markets and in government are more sensitive to the "carrying charge" of the pension plan than the raw numbers that comprise the NPL.

**Projection of Expected Future Changes**

We agree with GASB's reaffirmation of the current practices concerning assumptions about future events. It is appropriate and necessary to make assumptions about automatic COLAs, salary increases, and future service, to create a reasonable method of valuing future liabilities.

Our disagreement arises where GASB intends to project the cost of ad hoc COLAs. The reason pension plans utilize ad hoc COLAs, as opposed to automatic COLAs, is so that they can make a decision about whether or not the COLA can be funded on a regular basis. There are many matters subject to recurring spending and appropriation, but governments are not required to report the likely present value of all future spending of those items on their balance sheet. The expenditures are reported when the decision to fund the program is made. The same should be true with ad hoc COLAs.

We also have concerns with the added subjectivity that arises when determining whether facts and circumstances exist to conclude that ad hoc COLAs are not substantively different from automatic COLAs. Actuaries and accountants should not be required to guess at future employer decisions.

**Discount Rate**

One of the issues that we find most troubling in the preliminary views is the introduction of a blended discount rate which uses a) the expected rate of return on plan assets and b) a high-quality municipal bond index discount rate. AFSCME opposes the introduction of the blended discount rate for a number of reasons.

First, the proposed standard, if adopted, would drive policy decisions because the blended discount rate will serve as a significant incentive to reporting entities to change behavior in order to avoid the inclusion of the municipal bond index rate in the discount rate calculation. Although we unequivocally support responsible funding of pension plans, there is a substantial likelihood that governments would feel pressured to make decisions to avoid the blended rate solely to enhance their funding status as reported on the balance sheet. For example, a government may be induced to issue pension obligation bonds that may be poorly timed out of the desire to avoid a much lower discount rate. It is not appropriate for these decisions to be driven by accounting rules. Instead, pension funding decisions should be made based on long-term planning and analysis.

Second, introduction of the blended rate will confuse reporting greatly – with some plans using a much lower (blended) rate and others managing to use the discount rate based exclusively upon expected asset returns. This will lead to a wider range of discount rates used by similar plans. While many end users of financial reporting may understand that a lower discount rate yields a higher liability, few will be able to accurately determine the substantial impact of lowering a discount rate by even 1% - an impact that varies by plan based upon plan demographics. Introducing an accounting measure that makes simple funding-level comparisons between similar pension plans more difficult will only serve to confuse end users.

Third, we see pension funding as a long-term activity. Not only are the governmental entities subject to GASB rules different than private plan sponsors based upon their long time horizon as discussed in '*WHY GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING IS—AND SHOULD BE—DIFFERENT*', but governmental revenues are often much more sensitive to market swings than other entities (2009 state tax revenues fell 8.5%, while 14 states had declines of over 10%). This increased pro-cyclical revenue behavior requires flexibility to fund more in strong years, and sometimes less in difficult economic times. And, while we do not condone irresponsible behavior (the cases that often appear in the headlines), many entities use this flexibility in a very responsible manner – and should continue to do so. However, the adoption of the blended rate will cause more difficult decisions during difficult times; forcing policymakers to choose between allowing a blended discount rate that may create significant deterioration in their jurisdiction's balance sheet, or cut back essential services at the time when they are most needed.

To summarize, while we appreciate the theoretical framework that the blended discount rate is based upon, AFSCME feels that this accounting measure has the possibility to drive decision-making, confuse end users and often remove flexibility from policy makers trying to navigate a volatile economic environment.

**Attributing Present Value of Projected Benefits**

Entry age normal (EAN) is now used by most pension plans to calculate the present value of projected benefits. However, a number of states and many municipalities, counties, districts and other governmental entities use different cost methods which also drive toward full funding. There is not a significant policy rationale for GASB to mandate the use of one actuarial methodology when other useful, accurate, and widely acceptable methods have been used for decades with no adverse consequences to transparency or usefulness of reporting. The differing methodologies do require different levels of contribution throughout employees' careers, but that choice of funding is a policy decision, not one that should be driven by the accounting rules.

To the extent that a reporting entity maintains its current non-EAN practice, the proposed rule will introduce different cost methods for funding and reporting within a single employer that will complicate matters for both reporting entities and end users. End users, in particular, will be faced with conflicting information as they seek to ascertain the financial condition of the reporting entity and the funding status of the pension plan. This confusion would lead to a loss of confidence in both the actuarial valuation and the financial report, making the process of coming to an understanding much more difficult. Stakeholders with differing points of view will seize on the conflicting information in a manner that will make the true financial condition of the reporting entity more opaque rather than more transparent. Therefore, it is essential that reporting entities have one set of pension accounting procedures based on a generally accepted methodology.

**ISSUE 4 — ATTRIBUTION OF CHANGES IN THE NET PENSION LIABILITY TO FINANCIAL REPORTING PERIODS BY A SOLE OR AGENT EMPLOYER**

**Amortization of Changes in Liabilities**

The attribution of economic gains and losses to yield 'interperiod equity' is misguided. The proposed standard overstates the nexus of various economic and demographic changes to the current cadre of employees. In contrast, many of the deviations in experience from assumed assumptions are matters related to plan administration and should properly be amortized over a longer period. For example, if mortality falls short of assumptions or more workers retire than anticipated, that is a change in cost for the underlying plan sponsor and not attributable to the current workforce. Therefore, it is inappropriate to attribute any of that cost to a specific group of current active workers.

Because the liability is attributable to the employer, the amortization of costs should be based on the employer's future timeline for paying those costs or recognizing those gains – not the average age or working life of an employer's workers.

**Asset Smoothing**

Asset smoothing is vital to creating relatively stable contribution patterns in funding pension plans. Such stability is essential for government planning purposes and the long term time horizon of government entities justifies current smoothing policies. Asset gains and losses are the most consequential gains and losses, in sheer size, in a mature pension plan. As such, limiting asset smoothing to a +/- 15% corridor will no doubt have the impact of distorting the financial condition of pension plans during investment peaks and troughs.

Our view is that making this change would again increase the pro-cyclical behavior that we view as troubling, especially since pension contributions are not the only pro-cyclical item in governmental budgets. Above we discussed how governmental revenues are very cyclical. Similarly, many spending programs are also quite cyclical, by their nature. Among the important goals of managing a public pension fund is to create funding and expense results that are as stable and accurate on a long-term basis as possible – accounting standards should not serve to exacerbate the cyclical factors that are the most significant challenges some governments face.

**ISSUE 5 — RECOGNITION BY A COST-SHARING EMPLOYER**

**Multi-Employer Cost Reporting**

It follows from the views we expressed on Chapter 3, that AFSCME does not support requiring the reporting of unfunded obligation on participating employers' balance sheets. We see little value in such reporting which may confuse end users. These employers typically report projected payments to the pension plan, which is the actual cash-flow that can be measured and accurately reported.

AFSCME also believes that such reporting will create substantial administrative work and cost, with little or possibly negative value. The New York Employees' Retirement System referenced above is a plan that has participating employers. We do not see the additional value in reporting the short-term, dramatic volatility the plan experienced on the balance sheet. We believe that such snapshot measures do more to distort the long-term funding position of such plans than it would serve to add transparency – particularly at both the high and low points in the market cycle. In addition, information on the funded status of these plans is already publicly available to interested parties.

**Allocating Shares of Pension Obligation**

The method suggested to allocate shares of liabilities is very troubling. Often, a multi-employer public pension plan determines contributions only upon active member data (such as a flat percentage of payroll). In this case, when a plan begins to become underfunded – it will create an incentive to terminate participation, if possible. The results would vary due to a variety of statutes, but we foresee situations where employers may seek to withdraw from a multi-employer fund, privatize functions, exclude future workers from the plan or otherwise escape paying contributions that go toward asset/experience losses that are directly related to their own participants.

If a government may withdraw from a multi-employer plan, or if it outsources functions to effectively limit employee participation, the plan in which the employer participates may experience significant adverse consequences especially in light of the fact that many public plans do not have withdrawal liability policies and we are not aware of any plan that assigns employers liability when they outsource functions employing a significant number of employees in order to escape pension obligations. The result will be a very heavy burden on those that remain in the fund.

We already are seeing some of this behavior due to increased contributions, especially in Michigan school districts where large swaths of workers performing support functions are being outsourced specifically to avoid pension contributions. This leaves the remaining employers responsible for the experience/investment losses of other employers' workers which is tantamount to a cost shift. Such results are inequitable and should not be accelerated by accounting rules.

To the extent withdrawal liability policies are in place or created, allocating responsibility based upon only the active population is misguided, and allows employers who have contracted over the years to transfer obligations to the employers who have grown. For example, in the private sector, UPS recently paid a large sum to get out of a multi-employer pension plan though much of the unfunded liabilities were not due to their own active members or retirees.

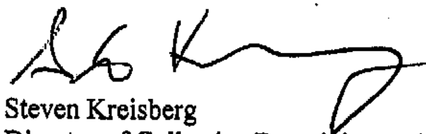
If GASB insists upon allocating shares of liability, which could be used in the future to establish withdrawal liability policies in legislatures around the country, AFSCME feels it would be far more accurate to allocate such liabilities by the share of total liabilities for each employer (a direct attribution method) – not contributions (which are often determined only by the actively working population). However, it is also important to note that some direct attributions methods have caused administrative difficulties (typically due to workers moving between participating employers). If GASB were to consider this method, we would encourage GASB to consider addressing this issue by suggesting a method that avoids the administrative burdens often associated with the direct attribution method.

**ISSUE 6 — FREQUENCY AND TIMING OF MEASUREMENTS**

Though it will add costs in a relatively small number of pension plans, AFSCME supports the proposal to require an actuarial valuation at least biennially. We feel that policy makers should make decisions based upon good, recent information and that this proposal adds value to that objective.

We appreciate your careful consideration of the foregoing.

Respectfully submitted,



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