



National Association of State Auditors, Comptrollers and Treasurers

July 29, 2009

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Mr. David Bean
Director of Research
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the National Association of State Auditors, Comptrollers and Treasurers, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's Invitation to Comment (ITC), *Pension Accounting and Financial Reporting*.

As requested, we offer the following feedback in response to the questions posed by the GASB:

1. To best achieve the financial reporting objectives of accountability and decision usefulness, including the assessment of interperiod equity, which of the following *processes related to pensions* do you believe governmental accounting and financial reporting should *provide information about*, and why?
 - a. The process by which an employer incurs an obligation to employees for defined pension benefits earned by them
 - b. The process by which an employer finances its projected future cash outflows for defined pension benefits
 - c. Both processes.

We believe that providing information about option b, the process by which an employer finances its projected future cash outflows for defined pension benefits, best achieves the financial reporting objectives of accountability and decision usefulness. However, half of our responding members believe that information should be provided on both processes.

2. What *obligations* of a sole or agent employer associated with pensions meet the definition of a liability in Concepts Statement No. 4, *Elements of Financial Statements*, and why?
 - a. A measure of the cumulative difference between (1) amounts expensed, based on annual required contributions of the employer to the pension plan pursuant to a program of funding pension benefits developed within established parameters, and (2) the amounts the employer actually has contributed to the plan.
 - b. A measure of the employer's unfunded accrued benefit obligation to employees at the financial report date related to the employment agreement governing the exchange of employee services for salaries and benefits.
 - c. Other. (Please identify the obligation that you believe best meets the liability definition.)

We believe that option a best meets the Concepts Statement No. 4 definition of a liability in that it reports the present obligation of the government based on a comparison of its required and actual contributions. This option is also based on the current pension reporting approach and is a successful and proven methodology for allocating costs to the appropriate periods.

3. Which of the following expense recognition patterns is more consistent with the concept, in paragraph 27 of Concepts Statement 4, that *applicability to a reporting period or periods* for purposes of *expense recognition* in government-wide, proprietary fund, and fiduciary fund financial statements should be determined based on the notion of interperiod equity, and why?
 - a. Recognition of the effects of transactions and other events that affect the unfunded accrued benefit obligation as they occur each year
 - b. Deferred recognition (deferral and amortization) of some or all components of pension cost other than normal cost over a number of future years determined by an employer or by plan trustees within accounting parameters.

We prefer option b, the deferred expense recognition method because it provides a strong measure of interperiod equity due to the relationship between the employer and the defined benefit pension plan. This method also enables the financial reporting to meet its objectives, frees funding from imposed constraints, yet does not preclude disclosures related to compliance and funding progress toward an employer's funding policy.

4. Should the projection of pension benefits include or exclude the following projected future changes? Why?
 - a. Automatic cost-of-living adjustments (COLAs)
 - b. Projected future ad hoc COLAs, in circumstances in which ad hoc COLAs are substantively a part of the employment agreement, as demonstrated by an employer's pattern of practice
 - c. Projected future salary increases
 - d. Projected future service credits.

We believe that all four options should be included in the projection of pension benefits, if they are part of the plan and are definable, because they are relevant factors in determining the amount of future benefits. However, options b, c, and d garnered less support for inclusion because they are not guaranteed, may be difficult to measure, and are subject to manipulation.

5. What should be the basis for determining the discount rate used for discounting projected pension benefits to their present value for accounting purposes? Why?
 - a. The estimated long-term investment yield for the plan
 - b. A risk-free rate (or a yield curve of risk-free rates applied to cash flows of different maturities)
 - c. The employer's borrowing rate
 - d. An average return on high-quality municipal bonds
 - e. Other.

There was a high degree of consensus that option a, the estimated long-term investment yield for the plan, should be the basis for determining the discount rate used for discounting projected pension benefits to their present value. Using this basis will best ensure alignment between projected and actual funding of pension liabilities. This approach is appropriate because it reflects the long-term estimated rate of return that the pension plan's assets will earn and that will be used to fund pension benefits.

6. *If, after due process, the accounting measurement approach adopted by the Board for pensions were to be one of those discussed in Chapter 4 that includes the amortization of some components of pension cost for purposes of recognition of an employer's pension expense:*

- a. Which actuarial cost method or methods should be permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? Why?

We believe the actuarial cost methods permitted for accounting and financial reporting purposes should be limited to entry age and projected unit credit. Reducing the allowable methods would result in improved comparability among governmental employers concerning the financial effects of their defined benefit commitments. The two methods cited will allow flexibility across diverse governments. The attained age method could be retained for the plans that are already using it.

- b. What should be the maximum amortization period or periods permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? Why?

We believe that 30 years is the appropriate amortization period to use. This method would ensure a systematic and comparable method for amortizing pension costs used by plans, which would improve the users' understanding of the plans. A 30-year amortization period is appropriate given the long-term financial view that has been traditionally taken in the pension and OPEB standards. The approach also leads to consistency in reporting for all pensions.

- c. Should different maximum amortization periods be set for different types of changes to the unfunded accrued benefit obligation? Why or why not?

Different maximum amortization periods should not be set for different types of changes to the unfunded accrued benefit obligation. Allowing the use of different maximum amortization periods allows for inconsistency in the way pension costs are recognized. It would also add increased complexity and would be burdensome for financial statement preparers, and would be confusing to the users of the statements.

- d. If you answered yes to question 6c, what should be the maximum amortization period for benefit changes applied retroactively to past periods of service that were not substantively a part of the employment agreements that established the compensation for services in those periods or were not previously included in the projection of pension benefits? What should be the maximum amortization period for actuarial gains and losses? Why?

N/A

- e. Which amortization method or methods should be permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? Why?

Our members do not agree on a specific amortization method. We believe a trade off should exist between amortization period and method so that any combination would ensure recognition of the unfunded accrued benefit obligation over a certain number of future periods. If this question is included in a subsequent Exposure Draft, we encourage the Board to clarify its intent because interpretations of the question varied widely among our members.

- f. What method or methods of determining the actuarial value of plan assets should be permitted for accounting and financial reporting purposes to determine an employer's pension obligation and expense? Why?

Several of our members stated that a reasonable smoothing period of up to five years should be used and that it should be limited in length so as not to disguise permanent losses or gains. Others stated that an average market value technique should be used because it acknowledges, without over-emphasizing, current market value fluctuations and reduces the risk of overreaction by report users to current market fluctuations. The criteria for spreading the effects of market value gains and losses should be a range of years.

7. Does the relationship between a cost-sharing employer and the cost-sharing multiple-employer plan in which it participates *differ enough in economic substance* from the relationship that a sole or agent employer has with the plan in which it participates to support different requirements with regard to liability and expense recognition? Which of the following views best represents your view, and why?
- The relationship does differ in economic substance, and current measurement, recognition, and disclosure requirements appropriately account for the pension cost and obligation of an employer in a cost-sharing plan.
 - The relationship does differ in economic substance, and current measurement and recognition requirements are appropriate; however, additional disclosures by cost-sharing employers are needed.
 - The relationship does not differ in economic substance; a cost-sharing employer has a long-term pension obligation based on the employment exchange and should measure and recognize its obligation and expense in a manner similar to that for sole and agent employers.

We believe that option a is the best option because the employer is required to contribute an exact amount each year. The plan is responsible for measuring the liability and has the obligation to set the contribution requirements to properly fund the pension obligation. The participating employers' obligations are to fund their contractually required contributions. Given these roles we do not believe it is cost beneficial or necessary to provide the additional disclosures discussed in the Invitation to Comment.

8. Which of the following should a pension plan report as its liability in regard to pension benefits, and why?
- A liability for benefits currently due and payable
 - The accrued benefit obligation, however measured.

We believe that the pension plan should report as its liability in regard to pension benefits a liability for benefits currently due and payable; therefore, option a is the best option. The liabilities recognized in the financial statements of the plan should only be those relevant to the stewardship of the trustees and administrators of the plan. We do not believe that the plan trustees can be held liable for the long-term liabilities resulting from employer plan design, contribution shortfalls, or investment earnings shortfalls where prudent investing standards have been met. Although pension benefits are "promised" at and during the time of employment, they are also subject to legislative control and can be modified within the limits of individual state's constitutions and related case law.

9. Should a presentation of changes in the unfunded accrued benefit obligation be a required part of general purpose financial reporting? Why or why not?
- If yes, which financial report(s) should contain that presentation: the employer's, the plan's, or both? Why?
 - If yes, should the presentation be a basic financial statement, a note to the basic financial statements, or required supplementary information? Why?

We believe that a presentation of changes in the unfunded accrued benefit obligation should be a required part of general purpose financial reporting because it is important information for the reader to understand how conditions have changed from the prior period. However, we believe that such information is not compatible as a financial statement with our preference for the current Net Pension Obligation approach because we believe the Net Pension Obligation meets the GASB definition of a liability while the unfunded accrued pension obligation does not. The responding members that indicated a preference as to whether such information should be presented for the employer, the plan, or both, believe that such information should be presented for the plan with about half stating

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that it should also be presented for the employer. Among our members that indicated a preference as to whether such information should be presented as a basic financial statement or as Required Supplementary Information (RSI), most believe that the information should be presented as RSI. However, it should be noted that several of our responding members opted for no presentation of changes in the unfunded accrued benefit obligation.

We appreciate the opportunity to respond to such an important document. Should you have any questions or need additional information regarding our response, please contact Kim O’Ryan of NASC at (859) 276-1147 or me at (517) 334-8050.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish". The signature is written in a cursive style with a long horizontal line extending from the start of the name.

Thomas H. McTavish
NASACT President