

September 28, 2011

Director of Research and Technical Activities – Project No. E-34
Governmental Accounting Standards Board
401 Merritt
P.O. Box 5116
Norwalk, CT 06856-5116

Subject: Response to Proposed Statement of the Governmental Accounting Standards Board: Accounting and Financial Reporting for Pensions

Dear Mr. Chairman and members of the Board,

The Virginia Government Finance Officers Association (VGFOA) appreciates the opportunity to work with the Governmental Accounting Standards Board (GASB) in the due process of improving accounting and financial reporting standards for pension.

I. Background

The Pension Exposure Draft proposes requiring governments to report in their statement of financial position a *net pension liability*; the difference between total pension liability and net assets set aside in a qualified trust to pay benefits to current employees, retirees, and their beneficiaries. It also proposes significant changes in how a government would calculate its total pension liability and pension expense. Other changes include:

- Establishment of pension plan and procedures for measuring and recognizing pension obligations
- Immediate recognition of more components of pension expense than is currently required, including the effect of changes in benefit terms, rather than deferral and amortization over the respective benefit terms for funding purposes
- Establishment of deferred inflows and outflows of resources (Statement 63, effective for financial statements beginning after December 15, 2011)
- Closed amortization periods (from open periods)
- Use of a blended discount rate for funded and unfunded pension liabilities

- A single actuarial cost allocation method—“entry age normal”—rather than the current choice among six actuarial cost methods.
- Requiring governments in cost-sharing multiple employer pension plans to record a liability equal to their proportionate share of net pension liability
- More extensive note disclosures and supplementary information
- Addressing accounting and financial reporting for different pension funding situations and plans
(i.e., special funding by non-employer, defined contribution pension plans, plans administered by qualified trusts, etc.)
- Addressing relevancy, information decision-usefulness, transparency, and accountability

Under the proposed changes, the methods and assumptions involved in measuring and reporting pension liabilities will be changed in ways dramatically affecting the Statement of Net Position and Statement of Activities of government entities. The proposed revision of GASB Statement No. 27 (Project No. 34-E) affects how jurisdictions will account for and report their involvement in pension plans while the proposed revision to GASB Statement No. 25 (Project No. 34-P) affects pension plans themselves. The proposed standards affect single employer defined benefit plans (effective for financial statements beginning after June 15, 2012), agent multiple-employer plans, and cost-sharing multiple-employer plans. For all other employers and for governmental non-employer contributing entities, the requirements of Statement No. 27 are effective for financial statements beginning after June 15, 2013. The major impact of the proposed changes will be in how pension liabilities are calculated, reported in the accrual basis statements, and disclosed in the footnotes to the financial statements to assist users of financial statements in their decision-making process.

I. General Comments:

We would like to take this opportunity to address our concerns and respond to the proposed revisions to Pension Accounting and Financial Reporting Statements No. 25 and 27. While we believe these proposed changes are intended to address concerns about the relevancy, transparency, and decision making usefulness, we urge the GASB to carefully consider costs and benefits. We believe the GASB should thoroughly perform an impact and feasibility analysis in implementing these statements in the proposed time frame. With these and future changes, government accounting will evolve from “simple and stable” to more “complex and volatile”.

The proposed statements involve many major changes and GASB should give the public adequate time to read and comment on these changes. To have these proposed revisions and many other accounting changes in addition to regular duties imposed upon financial reporting staff, would risk damaging rather than improving fiscal responsibility.

Pension calculations is a complex concept. The current exposure draft is difficult for an experienced finance professional that typically does not possess extensive knowledge of pension accounting to understand. A variety of pension plans from a variety of employers (single, agent, cost-sharing) is to be clearly addressed. Additional resources

with specific skill sets will have to be added to the Finance Department to handle the update and roll forward of the measurement of collective total pension liability to the extent practical. Illustrations and examples in Appendices are neither consistently illustrated nor clearly explained. The following major changes should be considered to improve the proposed accounting and reporting requirement:

- Frequency and timing of measurements - annual actuarial valuation (currently, employers contribution rates are determined based on an actuarial valuation report that is continuously lagging by two years)
- Consistent application of related assumptions and calculation methodology for pension to OPEB and any other post-employment benefits
- Roll-forward update procedures with limited update to key assumptions
- Use of discount rates based on relevant pension plans
- More dynamic and not static actuarial assumptions
- More specific illustrations for each type of pension plans

II. Specific Comments:

A. Comments – Collective Total Pension Liability:

The VGFOA agrees with the GASB Board's view that employers sponsoring sole-employer pension plans are financially accountable for those plans, and therefore, retain the primary responsibility for their funding resulting from employment exchange. This position is rooted in the concept of financial accountability and matching expenditures/expenses to the period incurred.

The question is how and when the pension liability should be measured and recognized. The proposed new rules would accelerate the reporting timeframe for all past service costs. Under these new rules, changes in the pension benefits and projected investment earnings would also be reflected in the balance sheet without delay. The balance sheet impact is significant to most governments and will create an unfavorable financial position, going from net assets position to net liability position. This transparency will leave pension funds open to governments promising more than they can afford to spend.

To adequately assess the pension liability, more frequent interest updates are unavoidable. These updates will require many changes across many organizations (governments, Virginia Retirement System (VRS), actuarial consultant companies, etc.). Governments will have to hire additional resources or pay for the cost of update actuarial valuation procedures and additional calculations related to requirements of the proposed standards. In Virginia, the majority of local governments and all school divisions' pension plans are administered centrally by the Virginia Retirement System (VRS) which provides for an advantage to those that participate as the additional specialized knowledge required by the new requirements will be acquired by VRS staff and the updates will need to be shared with the participating organizations in a form that can be utilized directly for the financial reporting purposes. However, VRS will need to streamline their update and review process to provide the information in a timely manner to participating organizations to ensure compliance. For those governments

administering smaller pension plans in Virginia, they will be required to incur higher costs for additional resources to administer these new requirements.

B. Comments – Pension Accounting and Reporting

The VGFOA believes that the changes in pension accounting and reporting would either result in delays in financial statement publication and/or audit opinions. Additional concerns are as follows:

- Frequency and Timing of Measurements – The VGFOA believes that in general, biennial actuarial valuations are sufficient during the stable economic time; however, because various primary governments participating in a cost-sharing plan, for example, may have differing fiscal years, it may be possible that a primary government may encounter a situation wherein the date of the most recent actuarial valuation available at the time of financial statement preparation exceeds 24 months prior to the employer’s fiscal year-end. We recommend that the GASB focus its requirements on the frequency of required actuarial valuation from the perspective of the fiscal year of the pension plan, rather than on the age of the valuations in comparison with the financial statement date of the participating employers, so long as it can be demonstrated that the employers used the most updated data available at the time of financial statement issuance. With respect to measurements, the VGFOA does not agree with the proposed requirements. Refer to the roll-forward update procedures below for specifics.
- Consistent application of related assumptions and calculation methodology for pension to OPEB and any other post-employment benefits – To improve the usefulness of any retirement-related analysis, the VGFOA recommends applying the pension-related assumptions and calculation methodology to OPEB and any other post-employment benefits. For example, the recommended sharing data is discount rate, single actuarial cost allocation method (entry age normal), and closed amortization period.
- Roll-forward update procedures – Currently as proposed in paragraph 49, if update procedures are used and significant changes occur between the actuarial valuation date and the employer’s year-end, professional judgment should be used to determine the extent of procedures needed to roll forward the measurement to the end of the employer’s reporting period, and consideration should be given to whether a new actuarial valuation is needed. Rather than making the update procedures or running a new actuarial valuation report an option, the VGFOA recommends either turning this step into a must do on an annual/more frequent basis or updating actuarial valuation reports with limited key actuarial assumptions (for example, interest rate) due to the sensitivity nature of pension to changes in interest rate for risk management and accountability purposes.

- Single vs. multiple discount rates based on relevant pension plans - VGFOA supports the GASB's position on discounting, but recommends the use of an algebraic method of calculating the blended rate and the use of a more relevant term index in accordance with pension plans in order to reflect the plan characteristics.
- More dynamic and not static actuarial assumptions - To roll forward the total pension liability using stale interest rate assumptions is not meaningful. An update to the interest rate can be easily obtained by subscribing to Treasury Yield Curve Rates published by U. S. Department of the Treasury.
- Amortization periods - Decreases in amortization periods from thirty years to a period reflecting the average remaining service lives of active employees for changes in assumptions and differences in experience in active employees will most likely result in shorter amortization periods. Hence, closed amortization periods are more meaningful than open ones. This, along with expensing these same items immediately for retirees will lead to higher pension expenses in a shorter term.
- Net Pension Liability (NPL) will fluctuate due to changes in the market value of the plan assets. In years where there are significant market swings, the NPL will appear to be larger or smaller simply due to volatility in the economic markets. This can be misleading to users of the financial statements who may not understand such economic changes.
- Since proprietary funds use the accrual basis of accounting, the employees of proprietary activities of a jurisdiction would have to be isolated and an actuarial valuation pertaining to them separately would have to be done in order to record their liabilities and expenses in the proprietary fund statements.
- Liabilities related to agent multiple-employer and/or cost sharing plans, such as those provided by the Virginia Retirement System (VRS) are to be closely coordinated with VRS. The VGFOA recommends allocating each participating jurisdiction's proportionate share of liabilities based on covered payroll.
- The proposed standards will require management of the deferred inflows and outflows, as each year will present a new layer of changes in proportion and changes in differences between actual plan contributions and proportion of total contributions to the cost sharing plan to be amortized over differing periods, requiring additional layers of accounting and record keeping.

- The proposed changes to reporting pension liabilities will not assist users of financial statements in their decision-making process since these “liabilities” will be volatile and will not demonstrate whether the jurisdiction is fully funding its pension obligations. These calculations will be difficult to audit.

The VGFOA strongly believes that these proposed statements present many implementation challenges and we appreciate the opportunity to share with you our comments for consideration. We are looking forward to reviewing the next version. Thank you for your consideration.



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