



September 22, 2011

Mr. David R. Bean  
Director of Research and Technical Activities  
Project Nos. 34-E and 34-P  
Governmental Accounting Standards Board  
401 Merritt 7  
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Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Exposure Drafts (EDs), *Accounting and Financial Reporting for Pensions an amendment of GASB Statement No. 27* (Employer ED) and *Financial Reporting for Pension Plans an amendment of GASB Statement No. 25* (Plan ED), and is pleased to offer its comments. As we have previously communicated in our responses to the related Preliminary Views (PV) and Invitation to Comment (ITC), we fully support the GASB's efforts to reexamine its current pension accounting and financial reporting standards. Given that significant changes to GASB's current pension standards are likely to occur as a result of this project, we encourage the Board to quickly complete the companion project to address the accounting and reporting for other post-retirement employment benefits (OPEB) to avoid future differences in the accounting and reporting for these two similar types of transactions.

We continue to agree with the Board's view that an employer remains primarily responsible for the portion of its pension liability to employees in excess of the plan net position available for pension benefits. We also agree with the Board that, to the extent that plan net position has been accumulated, the pension plan is primarily responsible, and the employer becomes secondarily responsible for the obligation. We also maintain that the employer's pension liability meets the definition of a liability; that the pension liability is measureable with sufficient reliability; and that the projection of benefit payments should include cost of living adjustments (COLAs), ad hoc COLAs, future salary increases, and future service credits. We are pleased that the Board has continued these positions. Further, we appreciate the Board's efforts to incorporate many of our recommendations from the ITC and PV into the EDs.

While we support many of the overall tenets of the Board's pension proposals, we do have a number of significant concerns relating to both EDs that we believe should be addressed prior to their final issuance. These concerns are addressed in the following section of this letter. Our additional concerns and related recommendations appear in the section of this letter titled, "Other Comments and Recommendations."

## **SIGNIFICANT COMMENTS AND RECOMMENDATIONS**

### ***Discount Rate Proposal is Overly Complex and Subjective***

We strongly disagree with the Board's discount rate proposals in paragraphs 22 - 25 of the Employer ED and paragraphs 40 - 43 of the Plan ED. We believe it is inappropriate to combine both a funding approach and a liability approach in establishing a "single rate." We also found the Board's proposed approach to be overly complex and subjective.

Additionally, allowing employers to take credit for future contributions may lead to the potential for abuse. Projected contributions are not based on objective criteria, and there is no certainty surrounding whether they will actually be made. Employers could easily state they are 'planning' for future contributions, even though the plan is significantly underfunded. Such action would allow the utilization of the investment rate of return which would be appealing to many employers. We also believe it is inappropriate for the Board to allow the benefit of a "funded rate" for discounting purposes during periods in which the amounts have not yet been contributed to the plan. We strongly encourage the Board to reconsider the 'run-off approach' to the discount rate, which we recommended in our response to the PV. This approach assumes no future contributions nor earned credits to the plan and bifurcates the discount rate into the funded and unfunded portions. The funded portion would consist of a projection of cash flows that would be performed to include projected asset growth based on the long-term rate of return and benefit payouts. This would define the benefit payments that could be supported by current plan net position plus the long-term rate of return. With regard to the unfunded portion, it would consist of an application of the unfunded rate (i.e., long-term return on operating funds or a settlement rate) to the remaining benefit payments after current net position runs out. We are happy to further discuss the specifics of our proposal in this area with the GASB staff to ensure an appropriate understanding and to answer any follow-up questions.

### ***Allocation Method for Cost-Sharing Multiple-Employer Plans Subjective***

We agree in principle that cost-sharing employers should recognize their proportionate share of the collective net pension liability, collective pension expense, and collective deferred outflows of resources and collective deferred inflows of resources related to pensions (referred to in this letter as pension elements). We also acknowledge that each potential allocation method has its flaws. However, we believe the projected long-term contribution effort allocation methodology the Board has proposed in paragraph 46 of the Employer ED is too subjective to be applied consistently and recommend the Board not adopt it in the final standard.

We are concerned the projected contributions are overly subjective and would not be determined based on objective criteria. This could lead to inconsistent application both

within the plan, due to varying inputs by employers, and between plans. Further, since each participating employer has to record the proportionate share of the various pension related elements for purposes of preparing their own financial statements, they need reliable and verifiable information surrounding the proportion calculation. Under the Board's approach, this will be problematic given the lack of distinct criteria surrounding projected long-term contributions for all participating employers. Finally, projected contributions could prove challenging from an audit perspective for some of the same reasons and due to the likely difficulty in obtaining sufficient appropriate audit evidence to support the allocation of participating employer pension elements.

As we stated in our response to the PV, we continue to believe a more simplified allocation approach based on covered payroll would provide a reasonable and straightforward methodology. We further recommend the allocation be based on covered payroll as of the actuarial valuation date unless significant changes have occurred between the actuarial valuation date and the plan's year-end. If there are significant changes, we recommend the use of covered payroll as of the plan's year-end. Actuarial experts we consulted indicated that given the relatively stable workforce in governments allocating based on covered payroll would provide a similar result as the Board's proposal, but would alleviate some of the disparity in practice. We understand the Board may have concerns that such a covered payroll approach could adversely affect smaller employers. If that is the case, we recommend the Board explore some type of normalized covered payroll approach, in lieu of a straight covered payroll, that would alleviate some of the negative impact on smaller employers.

***Essential Information Lacking Regarding Allocation of Collective Pension Elements in Cost-Sharing Multiple-Employer Plan Financial Statements***

As stated previously, we agree cost-sharing employers should recognize their proportionate share of the pension elements. However, we have significant concerns that the Board's proposal does not address how the participating employers will obtain sufficient, reliable, and verifiable information on which to base the reporting of their proportionate share of the collective net pension liability, collective pension expense, and collective deferred outflows of resources and collective deferred inflows of resources related to pensions. There are a wide range of potential solutions to this problem. We believe the Board is in a position to alleviate some of the burden of facilitating the exchange of reliable and verifiable information between plans and employers through the plan's financial reporting package.

The most effective way for the Board to address this issue would be to require a statement of the allocation basis for each employer as a basic financial statement or a required note disclosure for each plan. We believe such allocation information is essential to one group of primary users of plan financial statements—the participating cost-sharing employers—and would not be detrimental or misleading to other users. Using our recommendation for

the allocation method described in the previous comment, the statement would present each employer's covered payroll. Including the information as a statement or required note disclosure would subject it to audit and would provide reliable and verifiable information for participating employers to assess when reporting their share of pension elements. While we recognize that providing this statement or required disclosure would require additional efforts by the plans and their auditors, we believe it would go a long way in alleviating requests of the plan by each cost-sharing employer (which in some cases number in the thousands) to verify its allocation.

Another alternative, although much less effective for both preparers and auditors, would be to include the above described plan allocation information as required supplementary information (RSI). Such a schedule would then serve as a starting point for participating cost-sharing employers and auditors to further evaluate and test. However, due to the limited auditor association with RSI, additional procedures would still be necessary by the employers and their auditors to understand the information. Extensive involvement from the plans on an ongoing basis would also be required. Requiring the schedule as RSI would still be better a solution than not addressing how employers will obtain sufficient, reliable, and verifiable information for the purpose of preparing their financial statements.

If the Board rejects all of the above alternatives, we advise the Board to consider whether there are other ways to assist each cost-sharing employer in obtaining sufficient, reliable, and verifiable information to base its required reporting for its collective pension elements in a cost-effective manner. If the Board does nothing to address this issue and decides to let the marketplace determine a solution, the Board should be aware that we believe an enormous burden will be placed on plans. Each participating cost-sharing employer will have to individually work with the plan to understand the allocation and test the inputs. Further, each employer's auditor would have to gain an understanding of the plan's allocation process and controls and test underlying data at the plan.

***Essential Information Lacking Regarding Employer Interest of Plan Net Position in Agent Multiple-Employer Plan Financial Statements***

Similar to the issues raised for cost-sharing multiple-employer plans, we have significant concerns that the Board's proposal does not address how the participating agent employers will obtain sufficient, reliable, and verifiable information to determine their interest of plan net position to record. As required by the EDs, the agent employer should measure plan net position using the same valuation methods that are used by the plan. Participating employers would not have information needed to perform such a valuation nor assess the plan's valuation without direct access to the plan and its records. We acknowledge that there are a wide range of potential solutions the Board can explore to address this issue. We believe the most effective solution would be for the Board to require plans to include a statement of each employer's interest of plan net position as of the plan's year-end as a basic financial statement or required note disclosure. We believe such

information is essential to one group of primary users of plan financial statements—the participating agent employers—and would not be detrimental or misleading to other users. Including this information as a statement or required note disclosure would subject it to audit and would provide reliable and verifiable information for agent employers to assess when reporting their interest of plan net position.

While we recognize that providing this statement or required disclosure would require additional efforts by the plans and their auditors, we believe it would go a long way in alleviating requests of the plan by each participating employer (which in some cases number in the thousands) to verify its interest of plan net position.

Another alternative, although much less effective for both preparers and auditors, would be to include the above described plan net position information as RSI. Such a schedule would then serve as a starting point for participating employers and auditors to further evaluate and test. However, due to the limited auditor association with RSI, additional procedures would still be necessary by the employers and their auditors to understand the information. Extensive involvement from the plans on an ongoing basis would also be required. Requiring the schedule as RSI would still be a better solution than not addressing how employers will obtain sufficient, reliable, and verifiable information for the purpose of preparing their financial statements.

If the Board rejects all of the above alternatives, we advise the Board to consider whether there are other ways to assist each agent employer in obtaining sufficient, reliable, and verifiable information to base its interest in plan net position in a cost-effective manner. If the Board does nothing to address this issue and decides to let the marketplace determine a solution, the Board should be aware that we believe an enormous burden will be placed on plans. Each participating agent employer will have to individually work with the plan to understand the valuation and test the inputs. Further, each employer's auditor would have to gain an understanding of the plan's valuation process and controls and test underlying data at the plan.

***Added Complexities Due to Differing Year-Ends of Agent and Cost-Sharing Employers for Measuring Plan Net Position***

We recognize that additional measures will still be necessary for plans, participating employers, and related auditors in order to facilitate reporting for those employers that have a year-end that differs from the plan's year-end. To address this timing difference directly, one option would be to change the timing for employer accounting and reporting for plan net position to a valuation within 3 months of year-end. Plans could then perform quarterly valuations of plan net position and provide employers access to verify the information or, to alleviate the interaction with the employers, could engage an auditor to audit the quarterly net position information of the plan. While valuations concurrent with the year-end of each employer would provide the timeliest information, we recognize that

the burden such reporting would put on a plan may be excessive. Therefore, the quarterly approach would be a practical solution.

If the Board does nothing to address this differing year-end issue and leaves it to the marketplace to solve, there will still be much interaction needed between the plans and employers. Regardless of the timing of measurement of plan net position, cost-sharing employers still need to allocate their share of plan net position. Therefore, if the Board adopts our recommendation above to provide additional information about the allocations in the plan financial statement reporting package, it will alleviate some of the burden and interaction relating to the differing year-ends.

### ***Changes in Proportion of Cost-Sharing Multiple-Employer Plans Should be Expensed***

We disagree with deferring and recognizing in future periods the net effect of a change in the proportion used to calculate the employer's share of the collective net pension liability and collective deferred outflows of resources and collective deferred inflows of resources related to pensions as described in paragraph 60 of the Employer ED. In our view, this deferral adds unnecessary complexity and presents disparity in the treatment of changes by cost-sharing employers versus single and agent-employers. We believe changes in proportion have no economic benefits to future periods. We recommend the Board revise the proposed treatment of the net effect of a change in proportion to expense any such change in the current period.

### ***Proposed Accounting for Unconditional Special Funding Situations Flawed***

Paragraphs 74 - 78 of the Employer ED discuss both conditional and unconditional special funding situations. We believe the accounting treatment proposed for unconditional special funding situations is flawed. Paragraph 76 of the ED provides that the employer would present the employer's net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions and pension expense net of the nonemployer contributing entity's proportionate share. We have a number of concerns with this netting approach.

First, we believe the underlying exchange transaction occurs between the employer and the employee and thus, the entire (primary) liability should be recognized by the employer. To present the net pension liability and related deferred outflows of resources and deferred inflows of resources net of the nonemployer contributing entity's proportionate share does not accurately represent the employer's obligation.

Beyond the underlying exchange transaction issue, the Board's definition of an unconditional special funding situation—that the legal responsibility of the nonemployer contributing entity to contribute is unconditional,—is flawed in two respects. First, the legal responsibility may not be clear in statutes and thus would have the potential for

widespread misinterpretation. Second, the definition refers to the legal responsibility of the nonemployer to contribute to the plan. We believe that in order to even consider a net presentation at the employer level, the legal responsibility for the unfunded liability would need to transfer to the nonemployer contributing entity go beyond just a responsibility to contribute. Contributions can be made for future service or for the current unfunded liability and do not necessarily result in the assumption of the liability. Even in situations where a statute provides for the transfer of the full responsibility for the unfunded liability to another unit of government, such responsibility cannot be irrevocably transferred because statutes can be changed.

Any special funding arrangement should be evaluated through GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The full net pension liability and related deferred outflows of resources and deferred inflows of resources should remain with the employer. However, the employer should be able to record a receivable or revenue for any agreement with a nonemployer contributing entity which meets the criteria under GASB Statement No. 33.

## **OTHER COMMENTS AND RECOMMENDATIONS**

### ***Tiered Effective Date Flawed***

We disagree with the tiered effective date proposed in the EDs. While we recognize the importance of these Statements, we believe most preparers will need time to prepare for implementation. Further, the number of entities that will qualify for the first implementation date of periods beginning after June 15, 2012, will likely be limited given the parameters set forth. Accordingly, we support one effective date for all entities for periods beginning after June 15, 2013. This date will give preparers sufficient time to work towards the implementation of these comprehensive standards. Having an option for early implementation would permit those preparers that are ready to implement early, to do so. If the Board continues with the tiered approach, we encourage consideration of a more relevant criterion than plan net position (e.g., covered employees). The relative size of a plan's net position is not necessarily indicative of the significance of the net pension liability to the government's financial statements.

### ***Frequency of Actuarial Valuation for Multiple-Employer Plans Problematic for Differing Year-Ends***

Paragraph 37 of the Plan ED requires plans to have an actuarial valuation of the total pension liability as of the end of the plan's reporting period or to roll forward amounts from an actuarial valuation as of a date no more than 24 months earlier. In addition, paragraph 18 of the Employer ED, permits the measurement of the employer's total pension liability through the use of update procedures to roll forward amounts from an actuarial valuation as of a date no more than 24 months earlier than the employer's most

recent year-end. The frequency of measurement required by the Board, in many cases, will cause issues for cost-sharing and agent employers that have a different year-end than the actuarial valuation date. Such employers will not be able to comply with the requirements in paragraph 18 of the Employer ED as biennial actuarial valuations will provide outdated information for a participating employer with a differing year-end. For example, consider either a cost-sharing or agent multiple-employer plan with a June 30 year-end that performs biennial valuations as of the beginning of its reporting period and then performs roll forward procedures. Further, assume the plan has participating employers with varying year-ends (e.g., June 30 and September 30). If the plan has an actuarial valuation as of July 1, 2014, to use for its June 30, 2015 reporting period, the plan would not need another valuation until its 2017 reporting period. The July 1, 2014 report will be 27 months old as of September 30, 2016. This would make it impossible for the employer to comply with the standard without delaying the preparation of its financial statements until the actuarial valuation is performed by the plan.

To alleviate this problem, we recommend the Board alter the Plan ED to require annual valuations within 12 months of year-end and alter the Employer ED to allow employers involved in multiple-employer plans to roll forward a valuation performed within 23 months of the employer's year-end. The Board has indicated it is sensitive to the additional cost associated with annual actuarial valuations. However, it is our experience that many plans are already performing actuarial valuations on an annual basis. Therefore, we believe requiring annual valuations would not be overly burdensome for most plans. Further, annual valuations by the plans will provide more timely and precise amounts for plans and employers to base their recorded amounts.

### ***Scope and Applicability Too Narrow***

The way the scope and applicability is presented in paragraph 4 of the Employer ED and paragraph 3 of the Plan ED, the Statements would only apply to pensions provided through pension plans administered through trusts or equivalent arrangements. We question why the scope of these EDs has this limitation as there are cases in which pension plans are administered outside of a trust. We understand the Board intends to address pension arrangements outside of a trust at a future date. However, we believe leaving such a gap in the accounting guidance is not prudent. This lack of guidance will be especially problematic for employer accounting because an employer still has a liability for pension benefits, whether or not a trust exists. We are concerned that without clarification there could be diversity in practice in this area. Our concern also extends beyond this project to OPEB because we understand the Board's pension standards will provide the basis for revisions to the current GASB requirements for OPEB. In many cases, OPEB plans are administered outside a trust. For all of these reasons, we suggest the Board seriously consider addressing the full population of pension benefits being provided with these Statements.

If the Board does not accept our recommendation, we are unclear about the appropriate accounting that should be used by pension plans that are administered outside of a trust. That is, would participating employers continue to apply the provisions of GASB Statement Nos. 25 and 27 prior to any amendments made as a result of this current pension project? Or, would such plans somehow be expected to consider and adapt the final guidance issued as a result of this project as level “d” GAAP. We recommend the Board clarify the guidance to be followed by these plans. Without such clarification, we are concerned there will be a resulting diversity in practice.

### ***Projected Unit Credit Actuarial Cost Method Best Measure***

We support the Board’s decision to specify the use of a single actuarial method and to eliminate potential variations in the application of the method. In our view, this will improve comparability and understandability regarding the impact of pensions on the elements of employers’ financial statements. However, we continue to disagree with the Board’s proposal to use the entry age normal actuarial cost method as a level percentage of projected pay and continue to support the use of the projected unit credit actuarial cost method.

Even though the entry age normal actuarial cost method is currently the most prevalent method in use today, we encourage the Board to change its position and require the projected unit credit actuarial cost method in the final standards. Based on our understanding from actuarial experts, the projected unit credit actuarial cost method is more explicitly intended to measure the accrual of pension benefits and its use would attribute pension cost to periods in a way that would be more representative of the way in which plan members accrue benefits. This method reflects how benefits are earned and how they get established and grow, and therefore, provides a better measure of the current obligation based on the benefit formula and how benefits accrue under the plan. As cited in the Basis for Conclusions, we also support the projected unit credit actuarial cost method because we believe that the total pension liability measure that results more closely meets the definition of a liability in Concepts Statement 4, *Elements of Financial Statements*—that is, a present obligation to sacrifice resources. In our view, the projected unit credit actuarial cost method could be applied to more closely reflect the specific benefit accrual patterns identified in the benefit terms than would the entry age normal actuarial cost method. Given that the most expensive stage of an actuarial valuation typically occurs prior to the application of an actuarial cost method, we believe that changing methods from the entry age normal actuarial cost method to the projected unit credit actuarial cost method would not be overly burdensome.

***Clarification Needed When Liabilities to a Defined Benefit Pension Plan Should be Recorded for Financial Statements Prepared Using the Current Financial Resources Measurement Focus and Modified Accrual Basis of Accounting***

We understand the concept of reporting short-term payables to a pension plan for legally or contractually required contributions outstanding as of the end of the employer's reporting period as well as the example long-term liability description discussed in paragraph 72 of the Employer ED. However, we are confused by the latter part of paragraph 72 which addresses the liability for financial statements using the current financial resources measurement focus and modified accrual basis of accounting. The ED states, "...an employer should recognize a liability to a defined benefit pension plan to the extent the liability is normally expected to be liquidated with expendable available financial resources." We believe many users have difficulty interpreting this concept in terms of employer pension contributions and recommend the Board provide additional guidance relating to when a liability is normally expected to be liquidated with expendable financial resources for these contributions. Our understanding is that this would usually be the same time at which the plan records a receivable in accordance with paragraph 22 of GASB Statement 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, but we would ask the Board to clarify this point.

***Guidance for Allocation of Pension Amounts to Proprietary Funds Needed***

We understand the Board has intentionally chosen not to include guidance on the allocation of pension elements to proprietary funds. We recognize that GASB Codification section 1500.102 related to fund liabilities states, "Bonds, notes, and other long-term liabilities (for example, for capital and operating leases, pensions, claims and judgments, compensated absences, termination benefits, landfill closure and post closure care, pollution remediation obligations, and similar commitments) directly related to and expected to be paid from proprietary funds and fiduciary funds should be included in the accounts of such funds." However, considering the complexity of potential allocation methods for pension elements, we recommend the ED include guidance on potential allocation methods to proprietary funds (e.g., percentage of covered payroll of each fund) to promote consistency in practice.

***Recognition of Deferred Amounts Should be Simplified***

While we agree with recognizing deferred amounts attributable to effects of actuarial differences and changes in assumptions related to economic or demographic factors attributable to active employee over a closed period, we recommend the Board provide more specific guidance as to the recognition methodology to promote consistency. Paragraphs 28.a.4.b (single and agent employers) and 59.a.4.b (cost-sharing employers) of the Employer ED require recognition using a systematic and rational method that is representative of employees' expected remaining service lives as of the beginning of the

period in which the change occurred. There are numerous ways to estimate remaining service life such as average, liability-weighted average, liability-change weighted average, amortization weighted average, or actual by individual. Our recommendation is to require straight-line recognition over 10-15 years over a closed period. Such a requirement would simplify recognition of deferrals and cap the recognition period similar to the treatment in paragraphs 28.b and 59.b for changes in plan net position.

If the Board maintains the guidance in paragraphs 28.a.4.b and 59.a.4.b, we ask the Board to provide an example of a systematic rational method to promote better understanding and consistency in application. Based on discussions with GASB staff, we understand the intent is to have each year be a closed period and recognized separately by a weighted scale. Further, we understand there is potential for multiple layers for different types of deferrals. Thus, if our understanding aligns with the Board's intent, we suggest the Board provide clarification. Further, we understand, based on discussions with GASB staff, that an entity could group different types of deferrals (e.g., experienced gains or losses) to minimize the layers. While we agree with grouping deferrals, we suggest the Board include an example in the Basis for Conclusions.

Similarly, if the Board maintains its position on the accounting for the net effect of a change in proportion for cost-sharing employers as described in paragraph 60 of the Employer ED, we suggest the Board clarify that the intent of the last sentence of paragraph 60 of the Employer ED is for each year to be a closed period and recognized separately.

***Clarification Needed Regarding Changes in Assumptions***

In reading the proposed guidance on how to account for changes in the employer's net pension liability in paragraphs 28 and 59 of the Employer ED, we questioned whether changes in assumptions would be deferred or expensed in the period of the change. We suggest the Board provide a list of examples of economic and demographic factors and assumptions to help clarify the appropriate treatment. Further, we ask the Board to clarify how such changes would be allocated to active versus inactive employees.

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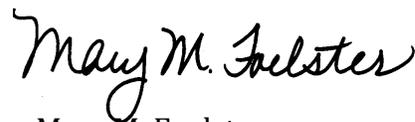
Mr. David Bean  
September 22, 2011  
Page 12

The AICPA appreciates the opportunity to comment on these EDs. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,



James C. Lanzarotta  
Chair  
AICPA State and Local Government  
Expert Panel



Mary M. Foelster  
Director  
AICPA Governmental Auditing and  
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cc: State and Local Government Expert Panel  
Richard Paul  
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