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July 31, 2009

Mr. David R. Bean  
Director of Research and Technical Activities  
No. 34  
Governmental Accounting Standards Board (GASB)  
401 Merritt 7, P. O. Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Governmental Accounting Standards Board (GASB) on its Invitation to Comment (ITC) on *Pension Accounting and Financial Reporting*. The FMSB, comprising 23 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately. We have the following responses to the questions posed in the exposure draft and some additional comments.

*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.*

The focus of accounting and financial reporting should be on both processes, identifying and reporting the pension benefit obligation to employees and the way in which the employer had financed the liability. The assessment of interperiod equity is best determined when users understand the liability generated from employees' service in conjunction with the assets that have been set aside to pay that liability. However, if we had to pick only one, we would pick (a) obligation, because that is based on the matching principle. It is useful to know how well the agency is funding the pension liability, even if the actuaries smooth out the normal fluctuations that occur in calculating the liability. We think that the GASB should not be concerned about whether providing two answers may be confusing, because this issue is inherently complex and if the readers cannot understand the differences between the two approaches, they are unlikely to really understand either one of the answers.

2. *What obligations of a sole or agent employer associated with pensions meet the definition of a liability in Concepts Statement 4, 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.)*

Conceptually, to meet the definition of a liability, we believe the amount must be the difference between what has been expensed and what has been contributed. Otherwise, what would be the debit offset to the credit to the liability account? So we think that the real difference between options (a) and (b) above is how the expense is calculated. We would prefer to base it on (b) the change in unfunded accrued benefit obligation, which is a reflection of the government's obligation relating to the exchange of employee services for salaries and benefits. However, since this amount can be dramatically impacted by non-operational events such as changes in interest rate or demographics, we would allow agencies to separately report the expense (or offset) recognized due to employer actions and outside forces. We could accept using the third alternative, deferring the expense amount that affects future periods, but that would not be our preference.

3. *Which of the following expense recognition patterns do you believe 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.*

Interperiod equity is best served by (a), though we would allow splitting the expense out into different sources if they are material.

4. *Should the projection of pension benefits include or exclude the following projected future changes? Why?*

- a. Automatic 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.*

Projection of pension benefits should include items a. and b. and not include items c. and d. Recognition of liabilities into the future should consider the likelihood of incurring that liability. We consider item a., automatic COLAs, to be very likely to occur and therefore should be factored in when calculating the liability. Since item b. predicates the COLA as substantively part of the employment agreement, we consider the likelihood of this occurring as also high enough to warrant inclusion in the projection of pension benefits. Items c. and d. we do not consider certain enough to warrant inclusion in the projection. We note that contracted salary increases can be negated by implementing furlough days. In doing projections, the usual assumption is that the COLA roughly matches the interest rate used to discount to net present value. We think COLAs, even ad hoc ones, are implicitly earned and should be included. However, salary increases above the COLA are discretionary and should be charged in the period they are made.

*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*

We support using the estimated long-term investment yield for the plan as the basis for determining the discount rate. Most pension plans set aside funds to cover the future outlays for pension benefits and most plans use a long term strategy to invest these funds. It seems appropriate to use this same long term yield to discount this long term liability. By using the same rate to discount your future liability as is used to project the yield for assets set aside to meet this liability, a government would be consistent in its present/future value calculations and may provide some level of comparability between the value of pension liability and the assets set aside to fund that liability.

The advantage of using the inflation rate is that it equals the COLA, eliminating the COLA from the formula. Of the rates listed above, we would support the risk-free rate, since it is easier to compute and does not encourage risky behavior. We don't like the borrowing rate because that rewards companies with (relatively) poor credit ratings.

*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 recommend limiting the actuarial cost method to just two: the entry age and the projected unit credit methods. As noted in paragraph 16 of the ITC, the entry age method is used by approximately 75 percent of large and 85 percent of small pension plans. When combined with the projected unit credit methods, over 90 percent of pension plans use one of these two methods. The Board should restrict

the number of actuarial methods to enhance the comparability of financial reporting among pension plans. Also, as noted in paragraphs 17 and 18, these two methods allocate pension costs over past, present and future periods which will allow financial reporting to incorporate the notion of interperiod equity. We would support eliminating the aggregate actuarial cost, frozen entry age and frozen attained age actuarial costs methods from use for accounting and financial reporting purposes. They improperly ignore past accounting periods and are used infrequently.

*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 would prefer to use the average remaining service life of the active plan membership, because that at least matches the expenses to the group for which the expenses were incurred. As stated earlier, however, we prefer to recognize expenses currently and not amortize them.

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

We don't support allowing different amortization periods. We prefer immediate recognition, and failing that, a shorter amortization period.

*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?*

We answered "No" to 6c, therefore have no response to this question.

*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?*

Although we support the immediate recognition of pension costs, if there were an amortization period, we would favor a closed amortization basis. As noted in paragraph 34, we agree that such an amortization basis is easier for users to understand. We also prefer the closed method because it will end with total recognition.

*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?*

For actuarial purposes, we support the smoothing of asset appreciation and depreciation over a three to five year period. It would be inappropriate to use fair value without smoothing since short term market spikes or declines would yield results that would be misleading to users. History shows that equity markets are volatile; therefore using a smoothing method for actuarial purposes would provide users with an appropriate valuation of the assets held. This assumes that these assets will be held for a long term. If any assets are scheduled to be liquidated in the near-term to meet obligations, then those should be valued at current market.

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?

a. 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.

b. The relationship does differ in economic substance, and current measurement and recognition requirements are appropriate; however, additional disclosures by cost-sharing employers are needed.

c. 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 support viewpoint a., that the relationship for cost-sharing plans does differ in economic substance from a sole or agent employer and that the current measurement, recognition, and disclosure requirements are appropriate. We view the plan as responsible for the liability and the plan has the obligation to set the contribution requirements so as to properly fund the pension obligation. Reference to a cost sharing plan's financial report by its members to obtain information regarding the plan is appropriate and members should not have to repeat information in their financial statements which is available in the plan's financial statements.

8. Which of the following should a pension plan report as its liability in regard to pension benefits, and why?

a. A liability for benefits currently due and payable

b. The accrued benefit obligation, however measured.

We support reporting item (b) the accrued benefit obligation. Reporting this obligation would further the goal of measuring interperiod equity when reporting pension benefit obligations. Since the plan exists for the purpose of meeting future obligations, we don't see how it can fail to recognize those obligations on the balance sheet. We would allow a plan to report the current portion separate from that accrued for later periods, just as entities report current and long-term liabilities separately.

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?

Yes, we believe it is appropriate to present changes in the unfunded accrued benefit obligation as part of general purpose financial reporting. This obligation is very likely material to a government's activities; it should be reported on the face of a general purpose financial statement and not relegated to the notes.

a. If yes, which report(s) should contain that presentation: the employer's, the plan's, or both? Why?

We favor the plan described in paragraph 14 of the ITC as it would not require an additional financial statement. We consider a financial statement that encompasses both the employer's commitment to

provide pension benefits and the accumulation of plan assets to fund those benefits as easier to understand by the users of financial statements. Adding another statement would add another complexity to the financial presentation for these reporting units.

*b. If yes, should the presentation be a basic financial statement, a note to the basic financial statements, or required supplementary information? Why?*

As noted above, we favor reporting this within a basic financial statement rather than in the notes. It is a material part of most governmental operations and it should be reported in the body of the financial statements to fully report the operations of the governmental entity. We support including a report of changes in the unfunded accrued benefit obligation. This should be part of both the employer's and plan's statements. Such a report would replace the need to split out the expenses by source as suggested in our response to (3) above.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions concerning the letter, please contact Anna D. Gowans Miller, CPA, AGA's director of research and staff liaison for the FMSB, at [amiller@agacgfm.org](mailto:amiller@agacgfm.org) or 703.684.6931 ext. 313.

Sincerely,



Robert L. Childree, Chair,  
AGA Financial Management Standards Board

cc: William A. Morehead, Ph.D., CPA, CGFM  
AGA National President

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Financial Management Standards Board**

**July 2009 – June 2010**

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