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David Bean, Director of Research and Technical Activities
Project No. 34
Governmental Accounting Standards Board
401 Merritt 7
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Dear Mr. Bean:

Local Government Academy, an independent nonprofit organization promoting excellence in local government and serving southwestern Pennsylvania, recently convened a roundtable discussion of the proposed standards contained in the Invitation to Comment (ITC) on Pension Accounting and Financial Reporting.

The following are some comments on the ITC for the consideration of the GASB. We appreciate the ability to participate in this process and thank the GASB for considering our comments.

Chapter 2 Questions

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 the financial accounting and disclosure should address both processes. It is not only important for the readers of the financial statements (residents of the governmental entities involved) to understand what contractual

liabilities there are for services that have been rendered, but also how the government plans on funding these contractual liabilities.

In the corporate world the current financial statements reflect the liability that has been currently earned by the employees for service that has been provided and we believe that consistent treatment for governments makes sense.

Chapter 3 Questions

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 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 b. meets the definition of a liability. For profit entities under FASB do record this liability and again for consistency with corporate accounting, we believe governments should as well.

We do not believe that the measure calculated in a. is really an asset of the government as it is not available for use by the government and a liability calculated under this method does not provide a complete picture of the government's obligations.

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.

We believe that the answer to this is a combination of both a and b. We feel that the concept that the liability and related expense should be recorded as the services are provided and the benefit earned should be key to any decisions that are made. However, saying that, if a transaction affects future periods, there should be options to amortize the impact of those components of pension cost over the periods affected.

Chapter 4 Questions

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

- a. Automatic COLAs

Since the benefit is contractually required, it should be included in pension benefit projections.

- 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

Yes, if a clear pattern is present. However, we have some concern about the judgment that would be involved in determining a clear pattern.

- c. Projected future salary increases

Yes, closest guess of what the liability is going to be would have to include some future salary increases. The government will clearly be giving salary increases in the future so they should be factored in.

- d. Projected future service credits

Some felt that similar to future salary increases; projected future service credits should also be included. Others felt that for calculating the liability of what is promised to date, this should not be included. The calculation would include only proportional service credits.

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 believe that the estimated long-term investment yield for the plan is the discount rate that should be used for the calculations. If you don't use a market rate of return on investments, you are ignoring actual facts or what has actually occurred. However, there may be an argument for a risk-free rate in irrational market conditions like we had in 2008.

Chapter 5 Question

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?

Entry age method should be the only method allowed. In the Commonwealth of Pennsylvania, entry age normal is required for all municipalities so there were be limited impact. Requiring one method would help to provide some consistency between the accounting, reporting, and funding of pension plans.

- 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?

Leave it at 30 years – good as any other.

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

Some felt that having different periods would not be a good thing as it would make the calculations too complicated. However, current calculations in Pennsylvania amortize different components over different periods currently and it seems to work.

A basic concept that needs to be maintained is when possible match the amortization period with the underlying period of related service.

- 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 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?

In these cases the liability should be recognized immediately to follow the concept of recognizing the liability as the service is being performed. The matching concept should be preserved. If you do have a maximum it should be no more than the remaining term of the elected officials awarding retroactive benefit changes.

- 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?

Closed, so that the unfunded liability has an end date to be funded. Using open you will never get to complete funding.

- 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?

Market value at the date of the valuation – require immediate recognition. Market is the observable, calculable amount and eliminates assumptions that people could play around with in the calculations.

Chapter 6 Questions

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 employers 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 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 c. is the answer as we do not believe there is a difference in substance between these types of plans. You still have the obligation as the employer. Of course the appropriate accounting and reporting could differ depending on the specifics of the plan documents. One concern raised was that in cost-sharing plans, the participating employers do not have control over what the other employers/employees do in the plan and because of this dynamic there may be some differences that could impact accounting and reporting. No specific examples on this potential impact were discussed.

Chapter 7 Questions

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.

First of all, there was some confusion in the group about what exactly was meant by benefits currently due and payable. If it is meant that these are the monthly benefit payments or annuity payments that are due to retirees or current employees as required by the Plan document, then yes these should be included. If you mean the accrued liability for pension benefits owed for service performed to date, we do not believe that this should be recorded since we do not believe that the Plan itself has the liability to pay these benefits, the government does.

Some individuals believed that to be consistent with the corporate reporting, that the liability for service already rendered should be recorded as a liability of the Plan. Future projected benefits should be part of the disclosures and would impact the future contributions and how you would ultimately fund the payments that the government will paying out in the future.

b. The accrued benefit obligation, however measured.

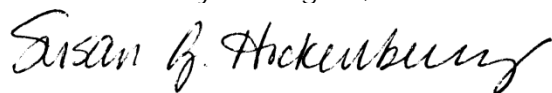
No, however, if you show the entire liability on the plan, you would need to show an offsetting receivable for the unfunded liability for the plan. And if you showed the receivable on the plan statements, wouldn't you have to report a liability on the government-wide statements of the government?

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?
- a. If yes, which financial report(s) should contain that presentation: the employer's, the plan's, or both? Why?
 - b. If yes, should the presentation be a basic financial statement, a note to the basic financial statements, or required supplementary information? Why?

We do not believe that this information should be reflected as a separate statement included in the audited financial statements of the plan. If this statement were required, it would make the most sense to include it in the Government's statements since it is the government that we believe has the liability, not the Plan. However, we believe that this could be reported in the footnotes as it is good information to include. This would basically be a summary of information from the actuarial report and would give the reader good insight as to why the unfunded accrued benefit obligation changed since the last study done. Another reason not to make this a statement is because actuarial reports in Pa are not done annually so you would have the same information two years in a row which could be confusing.

We appreciate the work of the GASB to improve Pension Accounting and Financial Reporting. Our thanks to Robert Lent, of Maher Duessel CPAs, for providing technical assistance to the group during the roundtable discussion and in the development of these comments.

On behalf of my colleagues,



Susan G. Hockenberry
Executive Director