



Providing Benefits for Life

September 17, 2010

Mr. David Bean
Director of Research and
Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
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Via e-mail: director@gasb.org

Subject: Project 34

Dear Mr. Bean:

As Executive Director of the Public Employees' Retirement System of Mississippi (MS PERS), I appreciate the opportunity to comment on the Governmental Accounting Standards Board's Preliminary Views on issues related to the Pension Accounting and Financial Reporting by Employers project. In addition to my written comments, I am requesting an opportunity to testify at GASB's October 27 public hearing to be held at the Crowne Plaza LaGuardia in East Elmhurst, New York.

I currently serve on the Executive Committee of the National Association of State Retirement Administrators and I am a member of the Governmental Accounting Standards Advisory Council. I have previously served on the Executive Board, as well as on other committees, representing the Government Finance Officers' Association, the Executive Advisory Board of the College of Business for Mississippi State University and as a member of the Legislative Committee for the National Council on Teacher Retirement. I am a Certified Public Accountant, Certified Government Financial Manager, Certified Public Manager, Certified Retirement Counselor and Certified Retirement Administrator with more than 30 years of experience in public pension benefits administration.

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MS PERS consists of one cost-sharing multiple-employer plan, the Public Employees' Retirement System; one agent multiple-employer plan, the Municipal Retirement Systems and Fire and Police Disability and Relief Fund; and two single-employer defined benefit plans, the Mississippi Highway Safety Patrol Retirement System and the Supplemental Legislative Retirement Plan. We also administer an IRC 457 defined contribution plan, the Government Employees' Deferred Compensation Plan and Trust and an IRC 401(a) defined contribution plan, the Optional Retirement Plan. MS PERS administers retirement benefits for all state and public education employees, officers of the Mississippi Highway Patrol, elected members of the state legislature, county and municipal employees, and other employees whose employers have chosen to participate in the System. We serve a total of 370,000 members, 893 employers, and 84,000 retirees with annual pension benefits in excess of \$1.6 billion.

It is evident from the Preliminary Views document that many hours of research, planning and careful consideration have gone into the development of the *Pension Accounting and Financial Reporting by Employers* project and I would like to commend the GASB for its efforts. The numerous changes contemplated by GASB are comprehensive and far-reaching in nature, affecting many different aspects of public pension accounting and financial reporting. Given the potential significant impact of the decisions the GASB will make, I believe it is critical that sufficient due diligence be performed to ensure the primary objectives of accounting and financial reporting; accountability, decision-usefulness and interperiod equity, are actually achieved. It is my understanding that the GASB expects to issue an Exposure Draft by June 2011. In view of the wide-ranging consequences of these proposals, I question whether this is a realistic target and ask that rather than allowing a proposed schedule to drive the release date, the GASB evaluate the time necessary to conduct the required due diligence and base the issuance of the Exposure Draft on that criteria.

Issue 1 – An Employer's Obligation to Its Employees for Defined Pension Benefits

1. It is the Board's preliminary view that, for accounting and financial reporting purposes, an employer is primarily responsible for the portion of the obligation for defined pension benefits in excess of the plan net assets available for benefits. (See Chapter 2, paragraphs 5–10.) Do you agree with this view? Why or why not?

I agree with this view to the extent the employer has the legal authority to establish the manner in which it will finance those benefits. In most public pension plans the statute creating the plan obligates the employer to a level of financing determined by the plan through its Board of Trustees. The plan has been given the power to determine the employer's annual obligation and, as a result, has "accepted" primary responsibility for the unfunded portion of the obligation. The employer's legal obligation at that point is to make the annual required contributions as determined and demanded by the plan's Board of Trustees. The employer's liability, if any, is the shortfall between actual contributions and annual required contributions.

Issue 2 – Liability Recognition by a Sole or Agent Employer

2a. *It is the Board's preliminary view that the unfunded portion of a sole or agent employer's pension obligation to its employees meets the definition of a liability (referred to as an employer's net pension liability). (See Chapter 3, paragraphs 1–8.) Do you agree with this view? Why or why not?*

I agree that in the case of sole or agent employers the obligation meets the definition of a liability as outlined by the Board to the extent an employer has a liability for the promise made to employees, either to provide the pension benefit when the employer has control over funding levels or to make the contributions demanded of it by the plan, if the plan controls the fiscal determination. As a related observation, presentation of the liability on the employer's financial statements will isolate the NPL from the actuarial assets and total liability from which it is generated because these items are not included in the employer's balance sheet. This will result in information that may be misleading to the users of the financial statements and result in information that is not decision-useful. Without a clear link to actuarial assets and total liability, the focus may change from the funding ratio and funding progress in general, to what may well be a volatile and less decision-useful net pension liability. For example, a \$40 million unfunded liability that is generated from \$45 million in liabilities and \$5 million in assets is very different from a \$40 million unfunded liability generated from \$300 million in liabilities and \$260 million in assets, yet both would look exactly the same in the employer's financial statements, but would not allow for the same interpretation without looking at the pension plan financial statements simultaneously. One plan is 87% funded, while the other is only 11% funded – a significant difference, yet one you would not recognize when looking at the employers financial statements.

Additionally, I question whether the net pension liability meets the financial statement element of the definition for liabilities of being “present obligations to sacrifice resources that the government has little or no discretion to avoid” as established by GASB in Concepts Statement 4. While the net pension liability may be an obligation of the employer at some point in the future, it clearly is not a present obligation; the only present obligation is the obligation of the employer for current contractually required contributions to the plan.

2b. *It is the Board's preliminary view that the net pension liability is measurable with sufficient reliability to be recognized in the employer's basic financial statements. (See Chapter 3, paragraphs 9–13.) Do you agree with this view? Why or why not?*

While I agree that the net pension liability is measurable, I am not convinced that it is measurable with sufficient reliability to be recognized in the employer's basic financial statements, especially divorced from the actuarial accrued liability and actuarial assets from which it is created. Additionally, in my view, the net pension liability described by the Board is not measurable with sufficient reliability for recognition in basic financial statements when the principles are applied to cost-sharing employers. These concerns are addressed in Issue 5b. – Recognition by a Cost-Sharing Employer.

Issue 3 – Measurement of the Total Pension Liability Component of the Net Pension Liability by a Sole or Agent Employer

3a. *It is the Board's preliminary view that the projection of pension benefit payments for purposes of calculating the total pension liability and the service-cost component of pension expense should include the projected effects of the following when relevant to the amounts of benefit payments: (1) automatic cost-of-living adjustments (COLAs), (2) future ad hoc COLAs in circumstances in which such COLAs are not substantively different from automatic COLAs (see also question 3b), (3) future salary increases, and (4) future service credits. (See Chapter 4, paragraphs 4–13.) Do you agree with this view? Why or why not?*

I agree that these items should be included in the calculation of a liability and that expectations for future changes, including automatic and ad hoc COLAs when not substantively different from automatic COLAs, should be included in projections of benefit payments.

3b. *What criteria, if any, do you suggest as a potential basis for determining whether ad hoc COLAs are not substantively different from an automatic COLA and, accordingly, should be included in the projection of pension benefit payments for accounting purposes?*

As to the criteria for including ad hoc COLAs not substantively different from automatic COLAs, it is my opinion that this would be a determination of the plan's actuary using professional judgment and knowledge of the plan. Ad hoc COLAs which require authoritative action, such as approval by a governing body, may truly be ad hoc and, in my opinion, should not be included.

3c. *It is the Board's preliminary view that the discount rate for accounting and financial reporting purposes should be a single rate that produces a present value of total projected benefit payments equivalent to that obtained by discounting projected benefit payments using (1) the long-term expected rate of return on plan investments to the extent that current and expected future plan net assets available for pension benefits are projected to be sufficient to make benefit payments and (2) a high-quality municipal bond index rate for those payments that are projected to be made beyond the point at which plan net assets available for pension benefits are projected to be fully depleted. (See Chapter 4, paragraphs 14–23.) Do you agree with this view? Why or why not?*

I agree with this view and commend the Board for its decision to use a long-term expected rate of return on plan net assets projected to provide for future benefits for current members. This element of the Board's proposal is consistent with a long-term view of performance rather than a focus on short-term fluctuations. Additionally, I agree with the Board's conclusion that projected future contributions from all sources should be taken into account. As all contributions toward funding the plan's unfunded actuarial accrued liability are related to benefits for current employees, those contributions should be included in the cash flow used to determine the point at which plan assets are no longer sufficient to meet plan liabilities.

3d. *It is the Board's preliminary view that for purposes of determining the total pension liability of a sole or agent employer, as well as the service-cost component of pension expense, the present value of projected benefit payments should be attributed to financial reporting periods over each employee's projected service life using a single method—the entry age actuarial cost method*

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applied on a level-percentage-of-payroll basis. (See Chapter 4, paragraphs 24–34, and Chapter 5, paragraphs 6 and 7.) Do you agree with this view? Why or why not?

While there may be issues for some plans who either are required to use or choose to use another method for funding, I agree with the use of the entry age actuarial cost method, as described in current standards, as the attribution method for determining present value of projected benefits.

Issue 4 – Attribution of Changes in the Net Pension Liability to Financial Reporting Periods by a Sole or Agent Employer

4a. It is the Board's preliminary view that the effects on the net pension liability of changes in the total pension liability resulting from (1) differences between expected and actual experience with regard to economic and demographic factors affecting measurement, (2) changes of assumptions regarding the future behavior of those factors, and (3) changes of plan terms affecting measurement should be recognized as components of pension expense over weighted-average periods representative of the expected remaining service lives of individual employees, considering separately (a) the aggregate effect on the liabilities of active employees to which the change applies and (b) the aggregate effect on the liabilities of inactive employees. (See Chapter 5, paragraphs 8–10.) Do you agree with this view? Why or why not?

I agree with the concept of recognizing the impact of all three over time but disagree with the manner in which the period is determined, with the exception of the impact of changes in plan terms for active members. However, in my opinion, it would be more appropriate to recognize changes in experience and assumptions over a fixed period of time that is more reflective of a working career and to recognize changes in the inactive liability over a period that is reflective of the future expected lifetime. Using fixed periods will reduce the cost of the calculations without material difference in the results obtained using weighted lifetimes for the active member liability changes.

4b. It is the Board's preliminary view that the effects on the net pension liability of projected earnings on plan investments, calculated using the long-term expected rate of return, should be included in the determination of pension expense in the period in which the earnings are projected to occur. Earnings on plan investments below or above the projected earnings should be reported as deferred outflows (inflows) unless cumulative net deferred outflows (inflows) resulting from such differences are more than 15 percent of the fair value of plan investments, in which case the amount of cumulative deferred outflows (inflows) that is greater than 15 percent of plan investments should be recognized as an increase or decrease in expense immediately. (See Chapter 5, paragraphs 12–15.) Do you agree with this view? Why or why not?

I do not agree with this view. I believe that the use of a 15% corridor around investment returns will tend to magnify the impact of market cycles on the pension expense. An important question to be considered is whether this method is effective against market volatility. Sudden changes or sustained periods of market movement away from the long term expected rate may cause the cumulative effect of the 15% corridor/deferral method to be ineffective as a smoothing mechanism. Once the corridor has reached 15%, the employer will continue to recognize any market change, in the same direction,

as an expense. Only a significant market swing in the opposite direction would prevent direct market volatility from affecting expenses. In fact, this approach may tend to magnify the impact of market cycles on the pension expense. During down-turn markets, this provision could force sharp increases in the pension expense at times when governments would be least able to absorb them. I believe the use of a smoothed asset value is more consistent with the Board's goal of a longer term view of operations and has the added benefit of significantly reducing the volatility of both the liability and expense measures thereby making those measures more reliable as representative of the long term expectations for those amounts. As a result I recommend any net pension liability, expense or deferral calculation reflect a smoothed asset value rather than the market value.

While I think that the use of a smoothed asset value is appropriate in the calculation of the net pension liability, expense or deferral, if it is the Board's view that there is a reversion to the mean around the assumed investment return, it would be more appropriate to recognize the assumed rate of return as pension expense on an annual basis and defer any earnings above or below that assumed rate. The 15% corridor is arbitrary, would introduce unnecessary volatility and does not reflect the Board's goal of a longer term view of operations.

Issue 5 – Recognition by a Cost-Sharing Employer

5a. It is the Board's preliminary view that each employer in a cost-sharing plan is implicitly primarily responsible for (and should recognize as its net pension liability) its proportionate share of the collective unfunded pension obligation, as well as its proportionate share of the effects of changes in the collective unfunded pension obligation. (See Chapter 6.) Do you agree with this view? Why or why not?

I disagree with this view. As a public pension sponsor of a cost-sharing plan, I am concerned that the positions expressed by the Board for sole and agent employers are not appropriate for cost-sharing plans. The relationship between an employer participating in a cost sharing plan and the plan is inherently different than that of the relationship of a sole or agent multiple employer. Employers who participate in a cost-sharing multiple employer plan do so for a variety of reasons, one being that by participating they can provide a pension benefit to their employees where otherwise it would not be cost-efficient or economical to do so. In a cost sharing arrangement, the employer understands the relationship with the plan and that there is an obligation to contribute; however, the individual employers have no authority over the plan. In fact, generally speaking, the legislature is responsible for establishing benefit levels and individual employers have no control over their liabilities or the contribution rate. Because of these facts, as well as the fact that the individual employers have no control over the required contributions and therefore no influence over the plan's funding levels, it would be inappropriate to require the employer to report a proportionate share of the net pension liability.

In illustrating the reasons for my disagreement with this view, I would like to share some examples that highlight the difficulties with mobility in the workforce and changes in employer participation as they relate to the application of the Board's suggestions for cost-sharing plans.

In addition to allowing employers to share risk, cost-sharing plans allow for more mobility in the workforce. In other words, a school district can recruit a teacher from another school district, or should a teacher relocate to another district, that teacher would not lose accumulated pension benefits. Workforce mobility has been a growing trend and is prevalent among employers in cost-sharing plans. In Mississippi, we have 893 participating employers, encompassing diverse areas of public service and covering basically all non-federal public employees in the state. MS regional medical centers and the university hospital employ healthcare professionals at salaries that are generally much higher than those of other employers, say municipal or Department of Transportation workers, and therefore have high contributions as a percent of payroll, which from a logical perspective might lead you to conclude that those employers should have a higher pension liability, however, that may not actually be the case due to employee turnover. As experienced healthcare workers, and others, move from one covered employer to another, the pension obligation for the individual is redistributed to the new employer, therefore effectively relieving the old employer of any liability, even though an employee may have worked the majority of his/her career with the old employer. Allocating the net pension liability based on the contributions assumes that the liability associated with an individual relates to the contributions paid and does not take into consideration the fact that the actual liability under a cost sharing arrangement has no relation to the contributions paid on behalf of an individual. Allocating the net pension liability, expense and deferral based on the contributions paid could produce a higher or lower allocation to employers than the actual liability represented by their employees and retirees at a point in time, which would not be representative of the employment exchange.

As another example of how the costs and risks are shared by all employers participating in a cost-sharing plan, a PERS employer recently offered an early retirement incentive program, in which a large number of employees participated, with bonuses as the retirement inducement. No additional service credit was offered through the program, nor was the bonus included in the average salary calculation; the early retirement incentive applied only to employees who were already eligible to retire. Under the Board's preliminary approach, due to the fact that a number of active members retired and, thus, contributions decreased, this employer's portion of the liability would be reduced while other covered employers' liability would remain probably increase as a result of the incentive program. Under current guidelines, the liability resides at the plan level making changes unique to certain employers imperceptible, yet each employer bears the undivided cost in the form of annual required contributions.

From time to time, employers join or leave a cost-sharing plan. Under the Board's proposed application, it would appear that a portion of the net pension liability would be allocated to newly participating employers in the first year. In other words, under the Board's proposed guidance, a new employer with no retirees and a payroll of \$1 million would have the same allocated share as an employer with the same dollar payroll who has been participating for many years. Rarely, but occasionally, an employer may leave the plan. In Mississippi, joining PERS is an irrevocable election and only through the dissolution of the public entity may an employer stop participating. However, this has occurred, generally through privatization. Under the proposed guidance, the allocated share of the net pension liability, expense and deferral would be redistributed among the remaining employers based on contributions or some other allocation method. However, current

guidance recognizes the true relationship of the employers to the plan and the allocation of the pension expense is distributed across all employers based on the contribution rate, which is not reflective of a liability associated with an individual employer. Since 2001, 10 MS PERS employers have terminated their participation in the plan and 39 employers have joined the plan. As illustrated by these scenarios, allocating the net pension liability based on contributions would result in a liability for an individual employer participating in a cost-sharing plan that would have no basis in fact and would not represent the true nature of the employment exchange.

It is widely acknowledged that there are significant differences between public sector and private sector pension plans. However, one similarity worth noting is found in the private sector defined benefit multiemployer, or Taft Hartley, plans which provide for financial reporting in much the same way as public cost-sharing plans under current guidelines. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers because assets contributed by one employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. It logically follows that if assets are not segregated, liabilities should not be segregated among individual employers. Taft Hartley plans are designed for portability; to provide benefits to workers as they move from employer to employer within the plan. Employers of these plans recognize as pension benefit cost, their required contribution to the plan for the period and recognize a liability only for unpaid contributions. These shared plan features are part of the advantage of cost-sharing multiemployer plans, whether they are in the public sector or private sector.

5b. The Board is considering basing the determination of proportionate shares of the collective net pension obligation on employers' respective shares of the total annual contractually required contributions to the plan and believes that would provide a reliable basis for measurement. However, the Board is seeking constituent input regarding other potential bases that might exist for this determination. (See Chapter 6, paragraph 8.) What basis, if any, do you suggest for determining a cost-sharing employer's proportionate share of the collective net pension obligation?

In my view, there is no reliable manner for calculating a proportionate share of the net pension liability that would reflect the employers' actual obligation and any allocation would distort the balance sheet of those participating employers, which would result in information that is not reliable or decision-useful. A cost-sharing plan functions much like an insurance pool and it is artificial to allocate the collective plan obligation and the effects of changes to individual participating employers. Additionally, unlike sole-employer and agent multiple employer plans, where the employer is liable in the event the plan becomes incapable of paying benefits, any deficiency in a cost-sharing plan would almost certainly be resolved collectively by means of additional contributions from all employers. The pension expense for these employers is the required contribution and any liability would be the difference in the amount required and the amount actually contributed.

Further, I believe that the impact on the financial statements could be substantial should the Board maintain the current view toward employers who participate in cost-sharing plans. The examples that I have shared with you center on the circumstances inherent in cost-sharing multiple-employer

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plans; that changes occur which cannot reasonably be allocated to produce a liability which is sufficiently reliable for recognition on the individual employer's balance sheet. If an allocation method is introduced, individual cost-sharing employers may be required to present a net pension liability estimate that bears little resemblance to actual substance, and thus, does not provide a reasonable foundation for decision making. In addition, if the allocation method is based on contributions, as suggested by the Board, there is no acknowledgement of the employment exchange with previous employers.

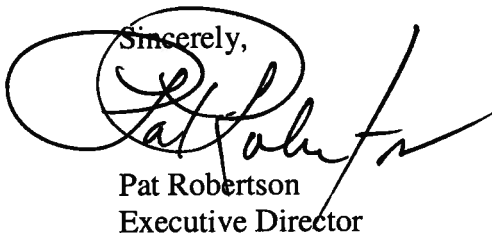
Issue 6 – Frequency and Timing of Measurements

6. The Board's preliminary view is that a comprehensive measurement (an actuarial valuation for accounting and financial reporting purposes) should be made at least biennially, as of a date not more than 24 months prior to an employer's fiscal year-end. If the comprehensive measurement is not made as of the employer's fiscal year-end, the most recent comprehensive measurement should be updated to that date. Professional judgment should be applied to determine the procedures necessary to reflect the effects of significant changes from the most recent comprehensive measurement date to the employer's fiscal year-end. Determination of the procedures needed in the particular facts and circumstances should include consideration of whether a new comprehensive measurement should be made. (See Chapter 7.) Do you agree with this view? Why or why not?

As a plan sponsor, I would like to express my concern that the cost of providing additional actuarial and accounting information to certain employers may be more than incremental and may outweigh any perceived benefits of allocating the collective net pension liability. From a practical standpoint, the plan would be required to treat these employers as if they were sole employers in terms of providing record keeping and supplying actuarial information.

In closing, I want to thank GASB for the opportunity to respond to your Preliminary Views on *Pension Accounting and Financial Reporting by Employers* and appreciate your consideration of my analysis and observations. As a public pension plan sponsor and a member of the Governmental Accounting Standards Advisory Council, I appreciate the role that the Board has played in establishing standards for governmental entities. I look forward to communicating with you again and would be pleased to answer any questions you may have regarding my views.

Sincerely,

A handwritten signature in black ink, appearing to read "Pat Robertson", written over a circular stamp or seal.

Pat Robertson
Executive Director