POINTS TO CONSIDER INCLUDING IN EMPLOYER COMMENTS

1. You are a user of financial statements. GASB itself has identified a number of things that it views as decisions and judgments related to pensions for which reported financial information is potentially relevant and useful. You may therefore wish to explain how some (or all) of these apply to you:

- Sizing of pension benefits and total employee compensation packages
- Funding of benefits (when and how much the employer and plan members should contribute)
- Proposed changes to plan terms that would affect eligibility for benefits or otherwise affect the amount of benefits
- Assessment of the funded status and funding progress of the pension plan
- Assessment of the overall economic condition of the employer, the employer's annual operating results, and the cost of government services

2. Your ability to make sound decisions will be impaired.

- De-linking pension accounting from pension funding, accomplished by eliminating the Annual Required Contribution (ARC), impairs decision-making. The ARC creates a target for policymakers to use in funding pension costs. In lieu of an ARC, the Net Pension Liability (NPL) proposed in the PV makes a poor funding target, not only because it often will be too large for many pension plan sponsors to fund in its entirety in any single year, but also because it is subject to significant change from one year to the next due to fluctuations in capital markets.
- Since the NPL will be based on the market value of assets, market fluctuations will make it much more volatile than the current measures. This extreme volatility and disconnect between the measure of liabilities used for funding purposes and disclosed in the notes to the financial statement, and that shown on the balance sheet, will create confusion. This confusion will not be useful in public policy decision-making, and could lead to choices that are inconsistent with the long-term nature of government and its role in maintaining and enhancing the well-being of its citizens.
- An overfunded pension plan could cause the employer's liabilities, using the NPL, to appear to be in net surplus. This would make the balance sheet suggest that the employer had no net liabilities. However, pension assets are to be used solely for the exclusive benefit of plan participants, and cannot be used as general revenues for other purposes. This distortion could seriously impair sound decision-making.

3. Accountability will be diminished, not enhanced.

- The ARC has promoted accountability by enabling users of financial statements to know whether or not plan sponsors are fulfilling their fiduciary obligation to properly fund the pension benefits under their purview. Removing the ARC would deny users this important information.

- Since the NPL would be based on the market value of assets, it would in all likelihood vary significantly from the number actually used to determine annual contributions (the Unfunded Actuarial Accrued Liability, or UAAL), since the UAAL is typically based on a smoothed value of assets. This difference between the two liability numbers will inevitably raise questions as to which number represents the "real" pension liability and "true" funded status of the sponsor's plan, and why funding decisions are not being made based on the NPL. Such confusion will diminish, not improve, accountability to users.
- Many governments have codified the ARC as part of their funding strategy, by requiring pension plan sponsors to pay the ARC as their annual contribution. Eliminating the ARC will make these contribution requirements moot, and with nothing to take their place, accountability as well as pension plan funding will undoubtedly suffer.

4. <u>Interperiod equity will be threatened</u>.

- The ARC helps achieve interperiod equity by charging the normal cost of plan benefits, plus an equitable portion of the cost to amortize the unfunded portion of the pension liability to each year within the plan's amortization period. This feature of the ARC helps ensure that current taxpayers and each cohort thereafter are fairly charged for the cost of services provided to them. Replacing the ARC with the NPL is likely to reduce interperiod equity, as the NPL is too large to be paid in a single year. The absence of a realistic annual funding target, combined with the inherent volatility of the NPL, will render virtually impossible the attainment of any real semblance of fairness in funding across generations of taxpayers.
- GASB's current smoothing provisions, which help permit the allocation of pension expenses to periods in such a manner that each period is charged a relatively stable, predictable percentage of payroll for normal costs, more equitably spreads the burden of an ongoing benefit program among different generations of taxpayers. The denial of the ability to smooth assets in determining the NPL threatens this interperiod equity rather than improves it.
- Because the NPL will account for such a large portion of an employer's liabilities, and since the NPL can change so drastically from one year to the next due to (unsmoothed) market volatility, a relatively small change in the NPL can exert a major and disproportionate effect on the state's overall liabilities. This outcome will render the basic financial statements virtually useless when it comes to trying to make difficult decisions regarding future spending for all an employer's responsibilities, not just pensions. The potential distortions this could produce in the funding of other areas of governmental responsibility, and the detrimental impact on future generations, could be significant.

5. The current GASB system is working.

- The current GASB standards are working well enough and do not justify the complications that would result from such drastic changes in the employer's balance sheet as the PV contemplates. Predictability and stability of required pension costs, which GASB's current approach encourages, are critically important to effective budgeting for governments. The imposition of the PV's changes would be unnecessarily disruptive, particularly in these difficult economic times, impairing rather than enhancing decision-usefulness.
- As pointed out in a 2008 Boston College Center for Retirement Research paper, "Before the [recent financial] crisis, most public plans were on a path to full funding as recommended by GASB." This is largely attributable to the fact that (as GASB itself has acknowledged), its current standards for pension accounting for governments "explicitly harmonizes accounting with the actuarial funding characteristics of public pension plans." Destroying this harmony is unwarranted.
- A wide array of users have become accustomed to accessing information from plan sponsor's financial reports that comply with current GASB standards. These uses include state legislators and other policymakers; public employees and employers; executive officials, such as governors, mayors, treasurers, and comptrollers; members of the media; and bond rating services. Significant changes to this reporting model could result in confusion on the part of the user community and could disrupt the consistency of public pension reporting. Such confusion and inconsistency could in turn reduce accountability and decision usefulness of public retirement system sponsors' financial reporting.

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