NFMA

October 11, 2010

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
410 Merritt 7
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Via electronic mail

RE: Preliminary Views of the Governmental Accounting Standard Board: Plain-Language Supplement – Pension Accounting and Financial Reporting by Employers

Dear David:

The National Federation of Municipal Analysts (NFMA) welcomes this opportunity to comment on the Preliminary Views of the Governmental Accounting Standard Board: Plain-Language Supplement – Pension Accounting and Financial Reporting by Employers (Project No. 34, dated June 16, 2010).

NFMA was chartered in 1983 as a not-for-profit association with the goals of promoting professionalism in municipal credit analysis and furthering the skill level of our members. We do this through educational programs and industry communication, providing an informed perspective on legal and regulatory matters relating to the municipal finance industry, and by facilitating the flow of information between investors and issuing entities.

NFMA membership includes approximately 1,000 members who evaluate credit and other risks of municipal securities. Members represent institutional investors, insurance companies, broker/dealers, bond insurers, and rating agencies. Credit analysts are present at all stages of the municipal securities market, from a transaction's inception to structuring, insuring, rating, sale of the securities, investing and trading in the secondary market. While each analyst's company may have a different role in the marketplace, understanding and communicating credit risk is the analyst's unifying link. As primary users of financial and operational information provided by municipal and other issuers, the NFMA typically supports measures that improve the quality and timeliness of that information.

To this end, we are providing comments on the Pension Accounting and Financial Reporting Preliminary Views. As users of governmental financial information, we are responding to the plain-language supplement. Our responses to the questions in the order they were posed within the plain-language supplement begin below.

Before we present these responses, the NFMA would like to highlight additional viewpoints and comments that arose from the weekly discussions among the group members who participated in this public comment process. First, as users of governmental accounting statements, the NFMA encourages and is supportive of GASB's efforts to enhance transparency in reporting and illuminate in greater detail the method and data to be presented by governmental entities in their accounting statements. Such data will be more useful to credit analysts as they prepare, rate, review, purchase, monitor and sell municipal bond offerings. To that end, our second comment is that when the final guidelines are prepared, we would advocate for the pension related financial data be located in single, easy to locate position within the final audit. The work that goes into preparing the pension information will be more usable if presented in a clear and concise manner, in a tabular format, at an easily identifiable location within the financial report. The availability of this comprehensive disclosure will allow for consistent comparisons across governmental entities. Finally, in the course of our review of the Preliminary Views for Users document, it was noteworthy that the only input requested concerned the liability-related aspects of the pension plan; comment regarding the determination of the asset value of the pension plan was not requested. Nevertheless, we would point out that while the market value based determination of the pension assets is better for the reality, the volatility on a year-to-year basis of the assets, and to follow, the liabilities and pension expense may result in unintended consequences should such variations affect the underlying credit quality of affected entities.

Questions 1 and 2: The Nature of the Pension Obligation

Do you agree or disagree with GASB's views regarding the nature of the pension obligation? Why do you agree or disagree? How do the GASB views affect the usefulness of the information to analyses, work and decisions you make?

The NFMA agrees with GASB's view that the nature of pension benefits equates to a form of deferred compensation that is earned as employees work for a government. In our opinion, the liability for future pension payments is incurred while the employee is working and should be recognized contemporaneously with such employment, even though the actual benefit payments are to be made in the future. It is also our opinion that the government employer is responsible, in full, for this pension obligation whether or not "sufficient" assets have been set aside to fulfill that obligation. The value of these dedicated assets can vary greatly over time and the determination of sufficiency is subject to many assumptions that may or may not bear out in reality. In our opinion, the pension plan, where dedicated assets have been set aside to satisfy this obligation, is a critical, but secondary offset to the government employer's primary responsibility. Ideally, the government employer should report on the dedicated pension plan assets, the gross pension liability, and the net pension liability. Furthermore, the data will be more usable to analysts if presented in a clear and concise manner, in tabular format, in one location, within the audit. This information would enhance a credit analyst's ability to assess a government's accountability by providing the ability to perform trend analysis on the factors that affect the net pension obligation, rather than on just the net pension obligation itself. To report on only the unfunded portion (or net pension liability) would not provide enough information to municipal analysts, thereby precluding them from the ability to make well informed decisions regarding the underlying credit quality of those governments.

In our view, the usefulness of this information as an aid to credit analysts' ability to evaluate issuers' financial condition and apply our conclusions toward decision-making would be greatly enhanced by more robust reporting of pension assets, liabilities, and the net pension liability. Such data would give a municipal analyst more complete insight into how a government employer is managing this form of deferred employee compensation. Furthermore, we strongly encourage the GASB to provide specific guidelines on the method of reporting this financial data. We would advocate that this information is provided in the body of the actual financial statements, rather than just in the footnotes, to allow for straightforward trend analyses across time and across government employers.

In agreeing with GASB's view regarding the nature of the pension obligation, we would also strongly encourage GASB to consider that credit and rating analysts will devise metric methodologies to provide ratio analysis of the pension data. Whether and how those metrics will consider gross pension, net pension liability (or the unfunded portion) and pension expense, among other measures, time will tell. However, be aware that this information is the basis of the municipal analyst's job: although credit analysts review the financial condition of individual issuers in their determination of the appropriate value of an issuer's bonds, this evaluation is performed by contrasting the financial condition of other governments inside and outside of that issuer's industry sector. Providing specific guidelines on the measurements and where these will be located within the final audit statements will greatly enhance the usefulness of this data as credit analysts incorporate it into their daily decision making.

Questions 3 and 4: Measuring a Government's Total Pension Liability

Do you agree or disagree with GASB's views regarding how the total pension liability should be measured? Why do you agree or disagree? How do the GASB views affect the usefulness of the information to analyses, work and decisions you make?

The NFMA agrees with many of the methods and assumptions that are proposed to be used in the calculation of the total pension liability. These methods and assumptions take into account: (1) the incorporation of expectations of future salary increases and years of continuing employment, among others, in the projections of future benefit payments; and (2) the inclusion of the automatic cost-of-living adjustments (COLAs) in the projection of future benefit payments. We also agree with the inclusion of ad hoc COLAs that, based on historical precedent, appear to be automatic benefit increases. We believe any standard or test, by which ad hoc COLAs will be deemed automatic, should be set with a "rolling" timeframe. Whereas ad hoc COLAs may be common practice in some states historically, given the current funding status of many plans, perhaps ad hoc COLAs will become less common in future years.

We also understand GASB's proposed methodology that the unfunded portion of the pension liability (the net pension liability or NPL) should be discounted at a more reasonable rate of return, that is, at a rate that is more in line with current market conditions, to more accurately depict the government's accountability for its unfunded pension liability. Moving away from the current practice of discounting the pension liability at the expected rate of return is a positive step toward a more accurate depiction of the liability.

With regard to the discount rate, we understand GASB's methodology for the determination of a "blended" rate. However, while we recognize the use of the expected investment return for the funded portion of the plan, we believe there needs to be more clarity on the guidelines regarding the use of a "high-quality municipal bond index rate" as a discount rate for the unfunded portion. We would recommend that the municipal index to be applied to the unfunded portion of the plan be based on a taxable rate, given that pension obligation bonds issued by governments are taxable, not tax-exempt. Additionally, we recommend a single index rate be selected to avoid the possibility of a wide variation of rates being applied by governments.

Municipal credit analysts review a wide variety of government financial statements in order to assess financial conditions as they determine underlying credit quality and ultimately the value of an issuer's bonds. Thus, it is imperative for the municipal analyst to have data that is consistent and comparable across sectors and issuer types. We are concerned that one problem created by the blended discount rate is that it does not allow comparability of these liabilities across governments. We would advocate for GASB to clearly devise guidelines that would require all governments to include within the body of the audit financial information and/or within the notes, the detail of the funded and unfunded portion of the overall pension liability, the discount rates used, and a calculation of total pension liability based on a common single discount rate. As we have attempted to point out throughout this response, credit analysts will devise ratios and metrics to not only evaluate the issuer's liabilities, but also to be able to efficiently compare and contrast several issuer attributes at once. We voice our concern that the use of a blended discount rate does not allow for consistent comparability across governments.

Questions 5 and 6 Reporting Changes in the Net Pension Liability

Do you agree or disagree with the GASB's views regarding when changes in the components (the expenses) of the net pension liability should be reported? Why do you agree or disagree? How do the GASB views affect the usefulness of the information to analyses, work and decisions you make?

Our understanding is that the expense figure that will express the changes in the components of the net pension liability (NPL) will be reported as aggregate sums reflecting the combination of three different figures: employer contributions (formerly the ARC), employee contributions, and changes in deferred inflows and outflows. Concerning the latter figure, our understanding is that this component will include the annual unrecognized investment gains or losses that exceed 15% of the calculated end of year pension assets. Furthermore, our understanding is that this information would be reported on the Statement of Governmental Activities, and as such, we would expect that the detail for the reconciliation of this data would be reported on the Statement of Activities. It is unclear as to where the remaining 15% would be reported. When evaluating an issuer's profile, credit analysts typically rely on the governmental and proprietary fund statements to provide the necessary detail of financial position to assess that issuer's accountability. Our assumptions are that the change in activity causing increases or decreases in the balance sheet and cash flow statement occur during the reported year. Concern arises over the exclusion of the full amount of unrecognized gains or losses, and the manner in which GASB staff has determined the extent to which amounts will be reported. As long as the 15% corridor is considered to be standard practice within the accounting industry, and so long as specific detail of the data included in this component, as well as the other components of the pension expense are specifically reported with an issuer's annual financial report, we would support GASB's views regarding changes in pension activity. The proposed revisions in how pensions are reported from a balance sheet driven measure to one that is determined by evaluation of pension expense first, will require extensive detail in the calculations so that the non-accounting investor and analyst community can understand, locate and decipher this new information.

We would also highlight the fact that members of the credit analyst community look at issuers relative to one another. In other words, comparability among similar sector entities and transparency in the availability of data is critical to affording fair evaluation of participants in the municipal credit markets. In addition, we note with concern the accounting versus funding distinction that GASB is setting forth, whether intended or not, regarding the differentiation between the amount of pension balance and pension funding a governmental issuer will report on their governmental statement of activities. It should be very clear to the users of the financial statements which figure is "actual" and which is the "intended actual" for reporting purposes. Finally, with respect to the question about interperiod assessment, this would certainly be a long-term goal to strive for, but we believe that more important for the accounting for pension reform that is currently occurring is the focus of timing of the annual data availability.

Questions 7 and 8: Governments in Cost-Sharing Plans

Do you agree or disagree with the GASB's views regarding governments in cost-sharing multiple-employer plans? Why do you agree or disagree? How do the GASB views affect the usefulness of the information to analyses, work and decisions you make?

The NFMA agrees with GASB's view that governments that participate in a cost-sharing multiple-employer pension plan report a net pension liability, as would governments in sole and agent multiple-employer plans. Notwithstanding our concerns and comments of the prior question, we believe that the addition of this data to issuer (employer) financial reports of those entities who participate in cost-sharing multiple-employer pension plans, would provide the ability to better compare entities who have their own plans and those who participate in [a] plan[s], but do not report the specific information on their financial reports. Such information would afford credit analysts' ability to determine a government's accountability on a singular basis, and in contrast to peer government entities, and allow for more informed decision-making regarding the government's underlying credit quality. We would also point out that in the case of cost-sharing plans, guidance for fair and equitable distribution of the pension liabilities would be clearly detailed.

Another concern that we raise at this time regards the timing of the availability of the data of not only the pension plan, but the government's applicable share of that pension plan. As analysts, we seek the most recent available data, but our understanding is that this particular dataset may be up to 48 months out of alignment with the issuer's financial reports. We encourage the GASB to advocate for the most current possible data under the auspices of a best practice method. Alternately, we would not wish to see an unintended consequence that issuer audits would be released later than is typical for these reports, because of the need to await final pension data. As such, our views with respect to the ability to assess interperiod data seem premature to comment on at this time.

Questions 9 and 10: Timing and Frequency of Pension Measurements

Do you agree or disagree with the GASB's views regarding the timing or frequency of the measurement of the net pension liability and its components? Why do you agree or disagree? How do the GASB views affect the usefulness of the information to analyses, work and decisions you make?

The NFMA agrees that the timing of the measurement of the net pension liability and its components should be reported as of the end of a government's fiscal year. However, we disagree with respect to the frequency of the measurement. We believe that an actuarial valuation of the total pension liability and the value of the plan assets should be made on an annual basis. The same twelve month reporting period should apply to the unfunded pension obligation. Annual actuarial valuation will result in a more accurate and current measurement, allowing for consistent comparability across each government's net pension liability. An annual net pension liability measurement will allow for a more up-to-date understanding of the nature and the extent of the government's obligation, in addition to affording the ability to consistently contrast and compare governments' liabilities among peers. Furthermore, we believe it noteworthy that pension funds, which manage upwards of tens of billions of dollars on behalf of their employees or the governments' employees, would not be required to perform reviews on an annual basis.

The NFMA would like to thank you for the opportunity to comment on the Pension Accounting and Financial Reporting by Employers Preliminary Views Plain Language Supplement, and appreciates the efforts GASB is taking to improve disclosure by municipal and related entities. We welcome the opportunity to discuss these comments at greater length.

Sincerely,

/s/
Mark Stockwell
NFMA Chairman