



February 2, 2016

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

Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Pension Issues*, and is pleased to offer its comments. We appreciate the Board's attention to practice issues relating to the GASB's pension standards and strongly agree with the changes proposed by the ED. These changes will promote a better understanding of the requirements, address practical considerations, and lead to more consistent application of GASB's standards in practice. Finally, we commend the Board's responsiveness to stakeholder concerns in all of the areas addressed in the ED.

The following section of this letter includes suggested clarifications for the Board's consideration. The final section of this letter, "Additional Pension Issues for Consideration," describes two additional practice issues that we recommend the Board consider addressing in the future.

Specific Comments

Include Examples of Covered Payroll. We support the proposed changes described in paragraphs 5 and 6 of the ED and the proposed definition of covered payroll. We also agree that presenting covered payroll (in lieu of covered-employee payroll) in the schedules of required supplementary information (RSI) (and in ratios that are presented in RSI) is a practical solution to the problems pension plans have encountered with the covered-employee payroll measure. However, as the change to the term covered payroll is slight and the discussion on this topic in the Basis for Conclusions is limited, we are concerned that some may overlook this change. Our sole suggestion is for the Board to include examples of covered payroll in the Basis for Conclusions or the Implementation Guide, similar to what had been included in the GASB's superseded pension standards.

Incorporate Definition of Deviation in Glossary. We support the clarification regarding the term *deviation* in paragraph 7 of the ED. However, to ensure a clear understanding that the term is derived from the Actuarial Standards of Practice issued by the Actuarial Standards Board, we recommend the definition of the term *deviation* be included in the glossary.

Editorial Suggestion for Employer-Paid Member Contributions. We appreciate the Board clarifying the employer-paid member contributions issues and support the changes proposed in

paragraph 8 of the ED. However, we have one suggested edit which is shown below in **bold underlined** text, to incorporate the wording in the Codification Instructions in Appendix C of the ED into paragraph 8. We believe this edit will make the final Statement more complete.

For purposes of applying Statement 68, those amounts should be classified as employee contributions, including for purposes of determining a cost-sharing employer's proportion **in conformity with paragraph 48 of Statement 68.**

Transition Provisions Need Clarification. The transition guidance in paragraph 10 of the ED needs clarification. The paragraph describes retroactive application requirements for the financial statements but also refers to paragraphs 5 and 6 of the ED which address unrelated RSI matters. Paragraph 11 appropriately addresses the transition guidance for RSI by citing paragraphs 5, 6, and 8 of the ED. Therefore, the references to paragraphs 5 and 6 should be deleted in paragraph 10 of the ED, leaving only a reference to paragraph 8.

Additional Practice Issues for Consideration

During our recent liaison meeting with the Board, we raised several pension practice issues our members have encountered that we recommend the Board address. It was recommended that we also include them in a more formal correspondence with the Board. Therefore, we have included below two of the most important issues that we encourage the Board to address in a future project.

Discount Rate Guidance Should be Reconsidered. As we have communicated in previous responses to due process documents, the Board should revise the discount rate requirements in both the pension and other postemployment benefit (OPEB) standards to limit the ability to use future contributions in the discount rate calculation. Our experience in working with preparers implementing the GASB's pension standards has only furthered our belief that the GASB's approach in this area needs to be reexamined.

The combined single rate "funding" and "liability" approach is deferring costs into future periods because plans do not have the ability to currently earn investment income on the unfunded amount. Further, the GASB's discount rate approach is too subjective and results in inconsistent application. Many significantly underfunded pension plans (i.e., 50 to 60% funded) are using the long-term rate of return for discounting the entire liability based on the adoption of a law or policy that requires employer governments to increase contributions in future periods so that eventually they will be contributing the full actuarially determined contribution amount. There is some question whether the participating employers will make such contributions in the future as we believe there are economic reasons well beyond poor investment performance that have resulted in so many pension and OPEB plans being underfunded. This places both employer governments and auditors in the difficult situation of evaluating the likelihood that the promise of increased future contributions will be made.

Our continued recommendation is that the Board reconsider the discount rate guidance to limit future contributions used in the discount rate calculation to the average contributions or average contribution rate over the last five-year period. If a government employer does, in fact, increase contributions in future periods, they will then be able to recognize the benefit of a higher discount rate as they fulfill their "promise" of increased contributions.

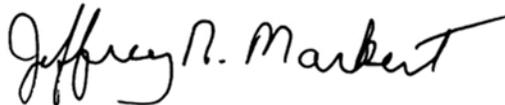
Accounting for Frozen Plans. One new area we have noted relates to the accounting for “frozen” defined benefit pension plans (i.e., plans where no future service is being credited to employees). We encourage the Board to address the appropriate accounting for these plans as they are encountered often enough in practice for the Board to provide accounting guidance to ensure consistency in practice. In developing such guidance, we believe the Board should consider an approach that terminates recognition of service cost as of the plan freeze date.

Paragraph 46 of GASB Statement No. 67, *Financial Reporting for Pension Plans*, describes the attribution of the entry age actuarial cost method that is required for determining the total pension liability. Specifically, subparagraph (d) states that, “The service costs of all pensions should be attributed through all assumed exit ages, through retirement.” Paragraph 46 (d) is silent on the treatment of frozen accrued benefits. If read literally and applied to a frozen plan, this would result in a significant gain (change in benefits) that would be recognized in full in the year the plan is frozen, and also result in the “re-recognition” of previously recognized expense in subsequent periods through assumed exit ages of active employees. This accounting results in the continued recognition of service cost after the plan is frozen. Our experience with frozen plans is that a successor plan is created (usually a defined contribution plan) to provide retirement benefits to employees. We believe that it is inappropriate to recognize pension costs (expense) for both a legacy (frozen) plan for which no future service is being credited to employees, as well as a pension cost for the successor plan. We also believe that since the amount of the frozen accrued benefits is entirely based on service rendered prior to the end of the fiscal year, the principle of the exchange transaction between the employer and employees would suggest that the obligation should be fully recognized when the plan is frozen.

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The AICPA appreciates the opportunity to comment on the ED. This comment letter was prepared by members of the AICPA’s State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,



Jeffrey N. Markert
Chair
AICPA State and Local Government
Expert Panel



Mary M. Foelster
Director
AICPA Governmental Auditing and
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cc: State and Local Government Expert Panel
Jim Dolinar
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