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Director of Research and Technical Activities
Project No. 34
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Dear Director:

On behalf of the Segal Company, we are writing in response to the GASB's Invitation to Comment (ITC) on Pension Accounting and Financial Reporting. Consistent with the ITC, in formulating our responses, we focused on the following factors:

- Accountability
- Decision usefulness
- Interperiod equity
- Transparency

Throughout this letter, we use common pension actuarial terms. Unless otherwise stated, these have the same meanings as defined in the Pension Actuarial Terminology section of GASB Statement No. 27. Also, unless otherwise noted, our comments generally reflect that the actuarial cost method being used is the Entry Age Normal Actuarial Cost Method described in Section B-2 of the Statement.

Chapter 2

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 government accounting and financial reporting should provide information about, and why?

- a. The process by which an employer incurs an obligation to employees for defined benefits earned by them**

- b. The process by which an employer finances its projected future cash outflows for defined pension benefits**

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c. Both processes.

To best achieve the financial reporting objectives of accountability and decision usefulness, we believe government accounting and financial reporting should provide information about the process by which an employer finances its projected future cash outflows earned by employees over their entire employment careers and not the process by which an employer incurs an obligation to employees for specific time periods during these employees total employment careers.

In supporting the financing approach, we agree with the observations in the ITC on the appropriateness of the method including the importance of tying the accounting reporting to the actuarial methods used to fund the plan. In particular, actuarial methodology provides a way to manage the relationship between streams of benefit payments and streams of contributions.

When using long-term reasonable assumptions (setting aside for the moment the issue of plan amendments or method changes), the current financing approach produces predictable level costs (either level dollar or, more commonly, level as a percentage of pay). This result is consistent with the long-term nature of public pension plans. Having said that, we agree that it is appropriate to limit some of the choices in methods such as those where the unfunded liability may never be amortized. This is addressed more fully in our response to Question 6.

To help users better understand the financing approach and to improve decision usefulness GASB may want to consider requiring projections of potential future results. Such projections would provide meaningful information rather than requiring accounting changes such as reporting the UAAL on the sponsor's financial statements that have limited usefulness.

We would also recommend maintaining the historical display of the ARC and UAAL including additional disclosure of the effects of any plan amendments, method changes, or assumption changes since the last reporting period.

We also agree with the ITC criticisms of the approach based on the employer's incurrence of an obligation for benefits earned. The cost pattern under this approach is contrary to public policy in that it violates the principle of interperiod equity in two ways - "globally" (longer term) and "locally" (shorter term).

First, because it is a simple present value of the accrued benefit, the cost (dollar amount as well as a percentage of pay) increases substantially as the member ages. This is especially true if the benefit accrual value is based on accrued service and current pay, but is also true even if the current year's benefit accrual value is based on projected pay at termination/retirement. Taxpayers receiving the same services over a member's career incur a systematically increasing cost, violating the principle of interperiod equity across that generation of taxpayers.

Second, the value of the accrued benefit increases sharply whenever the member attains eligibility for some level of subsidized retirement benefit. Thus, the cost to taxpayers in the year of eligibility would be dramatically higher than the cost for the year just before and just after

eligibility. This violates the principle of interperiod equity on a more year-by-year basis, within a generation of taxpayers.

Finally, some measures of the incurred obligation require the present value of the accrued benefit to be determined using current market yields on a cash-flow matching portfolio of high quality bonds. This introduces additional short-term cost volatility, since the cost in a given year would include the entire impact of any change in the market interest rates since the prior year.

In summary, the cost incurred by a taxpayer in a given year should not be dependent on how far along the members are in their careers, or short-term shifts in bond yields. At best this approach is confusing and at worst, misleading and subject to misuse.

Furthermore, compare the usefulness of this information. If the resulting cost in 20xx based on this approach were \$50 million and the cost in the year 20xx+1 were \$100 million, what can the user of financial information expect for the cost in 20xx+2? Will it again double, stay the same or be half of what it was for this year? What will cost do in subsequent years? In our opinion, providing so-called “market-based” results does not provide useful information and should not be the approach.

Below we address specifically the concerns raised by those who are advocates of the incurred obligation approach:

Concern #1

The funding process does not directly measure the obligation and does not currently require reporting events that create or change the amount of the obligation such as retroactive benefit increases based on past service.

The funding process does measure the obligation; however, it reflects that the obligation is of a long-term nature and does not include short-term eligibility and economic conditions that can easily change even before the next reporting period. Unless the decision-makers are considering terminating a plan and paying out all obligations immediately, they would not need to know the exact settlement obligation at a given point in time. A level cost approach that allocates the entire value of a member’s benefit over a working career (using both an actuarial funding method for allocating liabilities and an asset valuation method for orderly recognition of investment gains and losses) provides a more appropriate long-term view. However, if plan termination is under serious consideration or is likely to occur, showing this additional information would be helpful.

Note that retroactive benefit increases based on past service affect both funding measures and incurred obligation measures, so that part of the concern is not accurate.

Concern #2

The funding process does not provide relevant, decision-useful information for employers’ decisions about pension benefit levels and proposed benefit changes by emphasizing annual employer contributions and funded status rather than the employment exchange and total compensation agreed upon for services rendered in each period.

Here we argue that an employer's decision to maintain or improve a pension benefit is far more likely to be based on predictable annual cost than the total compensation for a particular period. If anything, this level-type pension cost is first subtracted from total compensation and then the remainder is evaluated for sufficiency. The remainder is allocated among compensation that is typically paid over a shorter time period (such as annual salary increases for the next three years). Again, the concept is to establish a level pension cost using level cost methods and best-estimate assumptions over time, not to favor or penalize one generation of pension plan members over another. Level cost most fairly and consistently measures the employment exchange and total compensation agreed upon for services rendered in each period.

As we have already suggested, a projection of future years' costs and funded status using the current basic methodology provides relevant and useful information to financial users who want to know what resources of the plan sponsor will be required to be allocated to the pension system in the future. We feel this is preferable to a measure that purports to be the "exact cost" of the employment exchange, but which in fact provides no information upon which the reader can draw any conclusions about the current year or future years' actual costs.

Concern #3

The funding process may understate the employer's obligation for benefits earned to date and overstate the funded status of the plan.

To the extent that reasonable assumptions are being used, it is equally likely that the employer's obligation will be overstated and the plan's funded status understated. Also, as described above, incurred obligation measures actually understate the level cost early in a member's career and overstate it in later years.

Concern #4

The funding process does not provide information useful in assessing whether interperiod equity has been achieved in regard to pensions.

Here again, level cost methods are actually more effective in achieving interperiod equity among taxpayers served by members over their careers. Under the incurred benefit method, interperiod equity will suffer as costs increase as a member ages, and also as costs vary widely from measurement period to measurement period based on changes in eligibility and market interest rates.

Concern #5

The funding process does not provide measures of an employer's accrued benefit obligation and expense independent of funding, based on the employment exchange, plan terms, and services received.

We believe that tying the benefit obligation to the funding method measure of the obligation is an appropriate and sound approach. The funding process is based on the employment exchange, plan terms and services rendered, but in a way that recognizes that a pension promise is most effectively managed as an exchange over a career of service. Adding the incurred obligation introduces an additional, competing measure that is not decision useful (except perhaps in a plan

termination scenario) and can lead to confusion and misuse. Again, we would caveat that a plan termination needs additional disclosure.

Concern #6

The funding process tends to obscure the actual volatility of the unfunded accrued benefit obligation and the progress being made in funding the plan by smoothing the results.

Other than in the case of a plan termination, the incurred benefit approach actually introduces unnecessary and irrelevant volatility for what is a long-term commitment.

Again, what is the purpose of trying to quantify this year-to-year volatility in a theoretically “market based” value? What conclusion or judgments can be drawn from this year-to-year volatility? Reporting year-to-year volatility (when it may not exist on a long-term basis) leads to the incorrect conclusion that funding volatility is inherent to defined benefit plans. This is not the case. Moreover, the result of drawing this unsupported conclusion leads to the inappropriate response of terminating defined benefit plans to eliminate contribution rate uncertainty.

Accounting measures *should* provide users, through transparent disclosure practices, with reasonable estimates of the funded level and future costs without prejudice based on type of plan or selected investment strategy. Accounting measures *should not* drive plan design by requiring information that does not recognize the plan sponsor’s legal structure and historic commitment to the plan. Moreover, these measures *should not* drive investment policy that may compensate for the short-term volatility but increase long-term cost.

Finally, concerning the question of showing results under both processes, we think this has limited usefulness, as users could then be selective in which set of results they decide to emphasize. Provided the long-term assumptions are reasonable and any plan or method or assumption changes are disclosed with their financial effect, the reader of the statement will have a good understanding of the plan’s current funded status and its status relative to prior years.

Chapter 3

2. What Obligations of a sole or agent employer associated with pensions meet the definition of a liability in Concepts Statement No. 4, Elements of Financial Statements, and why?

a. A measure of the cumulative difference between (1) amounts expensed, based on annual required contributions of the 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 both a. and b. meet the definition of a liability under Concepts Statement No. 4. However, since the primary focus of a public pension plan is on a going concern basis and not a liquidation basis, we feel that a. is a better measure for balance sheet disclosure. Choice a. measures the employer's commitment to following its funding policy, which is perhaps the best measure of accountability. Since the notes to the financial statements include information on the unfunded actuarial accrued liability, we do not believe it is necessary to alter the current approach of recognizing only the NPO on the balance sheet. However, we would endorse expanding the footnotes to include more information on the unfunded actuarial accrued liability and the transactions giving rise to it.

We suggest that there are four critical pieces of information needed for financial statements:

- Current cost
- Shortfall or excess of assets relative to cumulative cost
- Current "required" contribution
- Shortfall or excess of actual to required past contributions

The current cost is the normal cost component of the ARC. Because the AAL is simply the accumulation of normal costs less accumulated paid benefits (in the ideal case of no experience gains or losses or changes in plan provisions, methods, or assumptions), the cumulative cost to date is the AAL. Comparing this AAL to the current assets measures the cumulative effect of all such past events that have not been funded; any shortfall is the UAAL. Another way of describing the UAAL is that any shortfall of assets relative to cumulative cost determines whether or not future contributions equal to the current cost in each future year will be sufficient to fund the plan.

Because the UAAL is not due immediately, it does not go through the income statement or on the balance sheet. However, it is disclosed and explained in detail in supplementary information.

The current "required" contribution is the ARC. This includes the normal cost component as well as an amortization payment for benefit, method, or assumption changes as well as liability and asset experience gains and losses.

The shortfall or excess of actual to required past contributions is the NPO recognized on the balance sheet. This supports the concept of accountability, as it gives prominence to the crucial question of whether the employer has met the actuarially determined contribution requirements.

3. Which of the following expense recognition patterns 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 deferred recognition is the more appropriate choice for most of the components of pension cost other than normal cost.

First, we address expense components other than normal cost that are not related to pension benefit changes. These include experience gain or loss components as well as assumption and method changes. The arguments here are parallel to the arguments for preferring the financing approach over the incurred benefit approach in Question 1. Immediate recognition of gains and losses such as the large asset losses that occurred in late 2008 introduces unnecessary volatility in the ARC from year to year. Recognizing all of an assumption or method change will also introduce undue volatility. Gains and losses as well as appropriate method and assumption changes should not be assigned to one group of participants or taxpayers but rather spread over a reasonable period. Deferring the recognition is far more likely to lead to intergenerational equity.

Second, in the particular context of pension benefit increases, the principle of interperiod equity leads to three basic principles:

1. The permanence and size of the funding source should generally balance or match the permanence and cost of the benefit increase.
2. The members who incur the cost of the benefit increase should generally balance or match the members who receive the advantage of the benefit increase.
3. Recognition that as part of collective bargaining, current employees often reduce income and/or other financial assets for themselves to provide plan improvements from which they may not directly benefit. Thus, it may be appropriate to recognize the cost of the benefit enhancements over a longer time frame than just the working lifetimes of current actives or those that directly benefit from the improvement.

The choice of amortization period for the deferred expense components is addressed in Question 6.

Chapter 4

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

a. Automatic cost-of-living adjustments (COLAs)

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

c. Projected future salary increases

d. Projected future service credits.

We believe that automatic cost-of-living adjustments should be included in projecting pension benefits.

Recognizing future ad-hoc COLAs (which have been previously provided by an employer's routine practice) presents competing issues. First, we believe the goal of an actuarial valuation should be to fund towards the ultimate/anticipated benefits at retirement (including any post retirement increases). However, the reason why the ad-hoc COLA increase practice is not automatic is often so that the employer can reserve the option not to continue that practice. This may be to insure that if the costs of the plan reach certain levels, such increases will no longer be provided. Also, such increases when they occur may be conditioned upon some other economic gain or offsetting cost reduction to the employer. If such future ad-hoc costs are required to be included in a current actuarial valuation, it may limit the employer's ability to achieve such future gains/offsets or to stop granting such ad-hoc increases as they are "already part of the current costs of the employer."

We believe that projected future salary increases should be included in projecting pension benefits. If the projected benefit is based only on current pay, it will increase substantially over a member's career. Taxpayers receiving the same services over a member's career incur a systematically increasing cost, violating the principle of interperiod equity across that generation of taxpayers.

We believe projected future service credits should be used to determine future eligibility for benefits. Future service should also be included in projecting future benefit levels, but only as a step in allocating the cost of those projected benefits to each year of service. In other words, the AAL should not be equal to the present value of all future benefits, but should be based on that present value.

Ignoring future service credits in determining eligibility is a serious breach of accountability as it fails to recognize benefits that have a reasonable probability of being paid in the future. This approach defers too much of the cost to future taxpayers. In addition, because of the higher cost being passed on to the future taxpayers, benefits for future members may be lower than they otherwise would have been.

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.

The crucial distinction here is between a future earnings rate (choice a) and a market pricing rate (choices b, c, and d). A future earnings rate is a discount rate based on the expected return on a portfolio of assets that will fund a future cash flow. A market pricing based rate is a discount rate based on the cost of borrowing that the market would charge in setting a price today for a future cash flow.

We believe that the discount rate should be a future earnings discount rate based on the estimated long-term investment yield for the plan. Our reasons are both practical and theoretical, and are supported by the principles of both decision usefulness and interperiod equity.

At the practical level, consider the basic funding equation for any pension plan:

$$C + I = B + E$$

where C = contributions, I = investment income, B = benefit payments and E = expenses.

Present values based on a future earnings discount rate improve the ability of employers to make decisions on the cost of both current benefits and plan improvements based on the expected contributions that, together with future investment earnings, will be required to fund the plan. Market pricing discount rates provide information about the cost of an entirely different transaction, one that does not reflect the expected actual cash flows for a pension plan.

Similarly, since a public pension plan is generally an ongoing commitment, a relatively stable long-term rate based on expected future earnings is more consistent both with the long-term nature of the plan and with the principle of interperiod equity. As in our discussion of Question

1, a future earnings discount rate supports the principle of interperiod equity in two ways - both “globally” (longer term) and “locally” (shorter term).

Public pension plans invest in portfolios that balance equity and fixed income investments with the goal of increasing long-term return at a reasonable risk. Because market-pricing discount rates are generally lower than the expected returns on such portfolios, basing present values and current costs on market rates will lead to costs that will tend to decrease over time. This violates the principle of interperiod equity across generations of taxpayers.

The other feature of market pricing discount rates is that they are often volatile in the short term. This would lead to taxpayers incurring widely varying costs from period to period for the same long-term benefit commitment, based on short-term fluctuations in the market yield curve that do not affect the actual long-term cost of the benefits. This violates the principle of interperiod equity on a more short-term basis, within a generation of taxpayers.

Note that the short-term volatility of market pricing discount rates also violates the principle of decision usefulness. Present values and costs that vary with short-term swings in the market yield curve do not provide useful information on the ongoing cost of either current benefits or benefit improvements.

In contrast, future earnings-based discount rates produce costs that are designed to remain level over time. They are also much less variable in the short term, and so avoid extraneous short-term contribution and expense volatility.

It is worth noting that, if a plan is being terminated or an employer is withdrawing from a plan, it may be appropriate to use a more market-based discount rate consistent with the interest rate at which any remaining obligation is likely to be settled. However, for public plans that sort of transaction is the exception, not the rule.

There is another way to see why present values for public pension plans should be determined using future earnings discount rates and not market pricing discount rates. It involves considering what financial quantity is measured by the particular value of each type of discount rate, and asking which of those quantities is decision useful for a public pension plan.

Recalling the basic funding equation of $C+I=B+E$, the future earning discount rate is set so as to anticipate investment income, one of the main determinants of the ultimate cost of the plan. As such, it reflects an estimate of a financial quantity – investment return – that is directly useful in understanding plan cost.

In contrast, a market pricing discount rate is fundamentally a measure of default risk, the risk of non-payment of the future cash flow that is being priced. Such rates vary from the high levels associated with speculative or impaired debt (“junk bond” rates) to the low levels associated with the most secure governmental debt (“risk free” rates).

While this range of default risks is crucial to market pricing of financial instruments, it is largely irrelevant to the cost of a public pension plan, which is determined assuming that the benefits will be paid. At best, a present value based on a market discount rate would allow comparisons with the market price of riskier financial instruments. Such a comparison has no practical value either in the financial markets or in measuring the cost that the pension plan imposes on the plan sponsor and/or the taxpayers.

One last way to see this distinction is to note that the values of these two different types of discount rates actually work in opposite directions. Going back to $C + I = B + E$, the future earnings discount rate measures how much of future benefit payments will come from sources other than contributions. This means that the discount rate *measures an offset to the cost*, and so a higher discount rate anticipates a lower ultimate cost for the pension transaction.

In contrast, the market pricing discount rate measures how much a lender must pay today for a promise of repayment later. This means that discount rate *measures the cost*, and so a higher discount rate anticipates a higher ultimate cost to the borrower for the transaction, through a lower purchase price from the lender.

In closing, these two types of discount rates measure two different financial quantities that are actually opposite in effect. Given that providing a pension plan is fundamentally a matter of funding the obligation, and not market pricing the obligation, it is clear which of these two opposite types of discount rates provides decision useful information.

Chapter 5

6. If, after due process, the accounting measurements 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?

The entry age normal, projected unit credit, aggregate and frozen entry age methods should be permitted. For traditional final average pay plans, our preference is for entry age normal. Plans using aggregate or frozen initial methods should disclose AAL and UAAL under entry age normal.

These methods allocate costs over the working careers of employees and incorporate the impact of future salary increases (upon which retirement benefits are expected to be based) into the current annual cost requirement. While aggregate and frozen entry age do not directly calculate as part of their methodology the accrued liability, they do result in amortizing the value of unfunded benefits over the future working lifetime of active members including those that arise from gains and losses.

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?

While we are not recommending any specific changes in the current maximum amortization periods, we would like to offer the following guidelines:

- As a general principle, an open or rolling amortization period should not be established where the amortization payment as a level percentage of payroll will result in a continued and sustained increase in the UAAL.
- If a plan currently has an open period where the UAAL is increasing (i.e. the current year's amortization payment is less than interest), the period should be closed and decreased each year until the UAAL is no longer increasing. Subsequent plan changes, experience gains or losses as well as assumption or method changes can be amortized over this period (i.e., one unfunded amount subject to this amortization period) or alternatively a separate amortization period may be established for each of these new bases that will not give rise to continued and sustained increases in the UAAL.
- A surplus, or negative UAAL, is a special circumstance. GASB may want to consider a minimum amortization period when a surplus exists.

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

We do not feel there needs to be a distinction among the types of changes to the unfunded accrued benefit obligations in setting the amortization periods. As long as these items are amortized on a reasonable basis using the guidelines in b., the calculated expense will meet the goals of accountability, decision usefulness, and interperiod equity. To the extent that a reconciliation of the UAAL is provided with the effect of plan amendments, experience gains and losses, assumption and method changes shown separately, the goal of transparency is also met.

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 substantively a part of the employment agreements that established the compensation 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?

See our response to 6b, and 6c above.

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?

Any method selected should fit the guidelines in b. If an open period is selected, it should be short enough to avoid increasing the UAAL too far into the future or for an extended period. Both level dollar and level percentage of pay methods are acceptable. The amortization method can also use a single base or multiple separate bases.

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?

Actuarial Standard of Practice Statement No. 44 (ASOP 44) provides guidelines for the selection of asset valuation methods. We feel that a method that complies with ASOP 44 should be available for accounting and financial reporting purposes.

Chapter 6

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 employer 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?

a. 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.

b. The relationship does differ in economic substance, and current measurement and recognition requirements are appropriate; however, additional disclosures by cost-sharing employers are needed.

c. The relationship does not differ in economic substance; a cost-sharing employer has a 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 that the differences between sole and agent employers sponsored Plans and those for Cost Sharing Plans as described in the Invitation to Comment are significant enough to warrant different accounting and measurement requirements. The level of funding of a retirement plan for a sole employer is a management function in which decisions (and the ability to make those decisions) are made on where to allocate/expend employer resources where necessary and ultimately the consequences of those decisions on deploying assets. As such, those decisions (i.e., expensing the actuarial required amount (ARC) and accounting for the cumulative

differences between those actual funding levels and the ARC) need to be reflected on the employer's income statement and the balance sheet. Disclosures on funding progress also are appropriate as they again relate to the decisions of management regarding deployment of financial assets. Furthermore, a sole agent employer who sponsors the plan also often has the ability to decide/influence some/all of the decisions regarding plan provisions, funding and asset valuation methods, the long-term assumptions as well as the plan's investment choices/allocation. This contrasts to a cost-sharing employer who generally has none of the choices/decisions regarding the funding of the Plan.

However, in a situation in which a cost-sharing employer has the ability to withdraw from participation in such a Plan and it is likely that such a withdrawal will take place, the amount/cost of withdrawing from the Plan needs to be accounted for directly on the cost-sharing employer's financial statements. (Again, this is consistent with the reporting of financial consequences of management's decisions regarding deployment of financial resources).

We do feel that financial users of a cost-sharing employer plan need to know more about how participation in such a plan may affect future financial commitments (i.e., contributions). Thus, in this connection, we would support the reporting in the disclosures to the financial statements of the cost-sharing employer the entire Plan's ARC over the last 5 years.

Chapter 7

8. Which of the following should a pension plan report as its liability in regard to pension benefits, and why?

a. A liability for benefits currently due and payable

b. The accrued benefit obligation, however measured.

We believe that the Plan's basic (Income and Balance Sheet) financial statements should not include the accrued benefit obligation. Therefore, we support the continuation of including as a liability on the Plan's financial statements only the liability for benefits currently due and payable.

Besides the reasons already stated earlier in this response to the ITC against including these amounts, it would seem to us that including the accrued benefit obligation as a liability on the plan's financial statements would also then require including the present value of future contribution requirements related to the employer's obligation to fund these accrued obligations. Not including the present value of these future contributions (which are often contractually and legally required) but including a future benefit obligation that is not currently payable would seem to us as not being an apples-to-apples comparison. If the purpose of including those future payments as a liability is because they are a requirement of the Plan to be made in the future, then the Plan should include as an asset receivable, those future contributions.

We believe that the current disclosures in the Plan's financial statements provide the necessary information regarding the funded status of the Plan (historic relationship of liabilities, assets, and UAAL).

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?

First, as articulated in the response to Question 8, we do not believe the accrued benefit obligation should be included in the Plan's income and balance sheet financial reporting. That would include any presentation or reconciliation of the unfunded accrued benefit obligation.

We also believe that such information does not belong on the employer's basic financial statements. First, we do not believe that changes in the UAAL from year to year should be reflected/accounted for in the income statement. The fluctuations in the UAAL in a current or prior year do not allow the user to make any judgments or conclusions about the pension expense in subsequent years other than that it can vary significantly (including that it can be either a positive or negative amount). The reasons for these changes in UAAL may offset each other over time. These changes in the UAAL are not funded 100% each year. Thus, it does not present useful information about future operations. This type of reporting will only result in financial analysts asking for future cash contributions to the plan for them to draw conclusions about the employer's ability to meet its other future obligations including any debt repayments. Second, we do not believe that the UAAL (or changes in the UAAL) should be included in the balance sheet (even if it is not going to be reflected in the income statement). The question would be why would only changes in the pension plan be reflected in the government's balance sheet? Clearly, the same economic forces that may be the reasons for changes in the pension plan's UAAL would also have economic impact on the other assets of the governmental employer. Why only the impact on the pension plan? Again, it would seem the purpose of isolating this aspect of the government's asset/liabilities is to discourage these types of pension plans and that should not be the objective of an accounting standard.

In addition, we do not believe that a Plan or Employer should present a third basic financial statement that would present changes in the unfunded accrued benefit obligation. Rather, we believe that the current notes disclosure present significant historical and current information regarding the unfunded accrued benefit obligation. However, we do believe that it would be useful to have additional note disclosure regarding historical information regarding reasons why there have been changes in the UAAL over time. These should include the impact of changes in methods, assumptions as well as benefit plan changes.

About the Segal Company

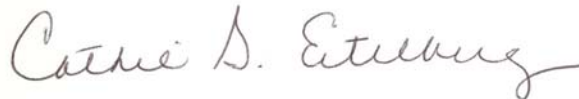
Founded in 1939, The Segal Company has extensive experience in providing independent, results-driven actuarial and consulting services to state and local governments. For 70 years, we have developed cutting-edge total reward approaches that provide quality health care, secure retirement, and competitive compensation programs for public employees. Offering comprehensive benefits requires governments to continually search for innovations. Many widely accepted benefit practice and cost containment solutions were originally designed by Segal.

Segal's accomplished team of actuaries and consultants serve as a resource to the public sector. Segal is active in the review and development of public sector employee benefit programs, and our leadership role in national public sector organizations is widely recognized.

Respectively submitted on behalf of The Segal Company.



Thomas D. Levy, FSA, MAAA, EA
Senior Vice President and Chief Actuary



Cathie Eitelberg
Senior Vice President
National Public Sector Market Director