COLORADO DEPARTMENT OF EDUCATION

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October 10, 2011

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

Sent via email to: director@gasb.org

Dear Mr. Bean:

On behalf of the Colorado Department of Education and Colorado School Districts we appreciate the opportunity to respond to the Governmental Accounting Standards Board's (GASB) Exposure Draft (ED), *Accounting and Financial Reporting for Pensions, an Amendment of GASB Statement No. 27*.

We have reviewed the ED and have serious concerns regarding applying the same treatment for single and Agent Employers to cost-sharing employers. These concerns, which are elaborated upon further in the remainder of this comment letter, are summarized in the following points: 1) this decision is a divergence from recently enacted *disclosure* standards for multiemployer plans issued by the Financial Accounting Standards Board (FASB); 2) The contradictory nature of the language in the ED which repeatedly refers to a "*collective* obligation" among cost-sharing employers versus the proposed requirement for each employer to record *individually* its proportionate share of the net pension liability; 3) The transitory nature of an individual's employment status within a state-wide cost-sharing plan; 4) the interpretation announced in the ED is inconsistent with the legal nature of the collective employment exchange ; 5) The ED would require public entities to record liability for pension benefit payment obligations that are not legally vested; 6) the ED creates unnecessary potential legal exposure; and 7) the proportionate share allocation concept taken to the proprietary fund level by the reporting entity will place additional undue financial pressure on the General Fund for Colorado School Districts.

Divergence from FASB

Recently, FASB issued an ED requiring new disclosure requirements for multiemployer plans. Per the FASB ED "Multiemployer plans have unique characteristics that contributed to the Board's consideration of a disclosure standard rather than a recognition or measurement standard at this time, including that multiemployer plans are cost-sharing plans, employers may have difficulty obtaining timely information from the

plan…" (Please see Section BC2. in FASB's September 1, 2010 ED *Disclosure about an Employer's Participation in a Multiemployer Plan*.) We concur with FASB's conclusion regarding the unique characteristics of state and local governments participating in a cost-sharing plan. These unique characteristics include a collective, not individual, obligation to pay plan benefits, the difficulty in obtaining timely (and accurate) information from the plan, and the fact that the extent of each employer's obligation to the plan extends only to its annual contribution. While certain of these arguments were put forth during the Preliminary Views stage and were rejected, we believe, based on FASB's actions, reconsideration of these arguments is in order.

Contradictory Language in the GASB ED

Paragraph 251 in the Basis for Conclusions and Alternate View of the GASB ED states:

> *Some respondents objected to the use of relative contribution requirements as the basis for an employer's proportionate share because, in their view, the resulting measures would not reflect an individual employer's obligation to its own employees. Some respondents suggested an alternative approach that would calculate, through separate actuarial valuations, total pension liabilities for individual employers for use as the basis for determining each employer's proportionate share of the collective net pension liability and related measures. The Board agrees with the respondents' evaluation of the effects of the required approach—that is, that the required allocation basis would not reflect the portion of the collective pension obligation that arose as the result of the employer receiving services from specific employees in past periods. However, the Board does not believe that is the objective of the measurement. Such an approach ignores an essential characteristic of cost-sharing plans—pooling of the benefit obligations of the employers. The Board believes that the lack of a one-to-one relationship to the original employment exchange is exactly reflective of the structure of a cost-sharing arrangement. That is, the employers have individual exchanges with their employees; however, the employers collectively are responsible for the collective obligation that arises from the individual exchanges.*

Here, and elsewhere in the ED, it is clearly stated that the employers are collectively responsible for the collective obligation that arises from the individual exchanges. While we concur that employers are collectively responsible for annual plan contributions, we believe it is inconsistent to attribute a "collective obligation" of future benefits to individual employers. Referring to the net pension liability as a "collective obligation" by definition negates the concept of an employer reporting an individual liability on its statement of net position. We contend that as a "collective obligation," the net pension liability should be booked at the plan level only with appropriate disclosure in the basic financial statements of plan participants.

Transitory Nature of Employment Status

Within any large cost-sharing plan, inevitably there is turnover between the various entities covered by the plan. For example, state employees covered by the state-wide pension plan could (and have) transitioned to a local school district covered by the same state-wide pension plan. The same is true for for employees of one school district transferring to a different school district covered by the state-wide pension plan. The transitory nature of an employee's status was considered by FASB in drafting its ED and

was one of several reasons for not requiring individual employers to record a liability on their financial statements.

We believe GASB should acknowledge that the practice does occur and potentially has a significant impact on the determination of net pension liability. At a minimum, GASB should, if it has not already done so, obtain empirical evidence that the level of turnover in the public sector is not a significant factor in determining the amounts required to be reported under this ED.

The New Interpretation of GASB Statement No. 27 is Inconsistent with the Legal Structure of Pure Statutory Pension Plans

At Paragraph 245 in the Basis for Conclusions and Alternate View of the GASB ED the Board notes that some respondents to the Preliminary Views document asserted that "cost-sharing employers are responsible only for their legally required contributions to the pension plan." The Board addresses this assertion at paragraph 246, stating that it "does not believe that the lack of ability to control the benefit terms or the manner in which defined benefit pensions are financed changes whether the employers collectively received the benefits of employees' services in exchange for compensation that included pensions." Rather, in the Board's view, "cost-sharing employers have an ongoing responsibility to financially support the benefits created by their collective employment exchanges with their employees."

The Board's conclusion in this regard stems from its view stated at paragraph 245 that, "in a cost-sharing plan, the obligation for pensions arises in the employment exchanges between participating employers and their employees." This premise and the premise that employer contributions to such a cost-sharing plan are contractually required are replete throughout the ED. These premises fundamentally misstate the legal nature of statutorily created pension plans with multiple governmental employers such as the Colorado Public Employees Retirement Association (CO PERA).

Public employees in Colorado are required to participate in CO PERA unless they are employed in a position that is statutorily exempt. For those employees who are required to participate, the employer, whether a central state agency or a legally independent entity such as a state institution of higher education, is required to make contributions to CO PERA on behalf of the employer and employee by statute. The pension benefit to which an employee is entitled by virtue of membership in CO PERA is defined in statute. There is no collective bargaining agreement and no contractual promise made by the employer beyond the promise that the employee will be enrolled in CO PERA if the employee is required to be enrolled in CO PERA by statute. Thus, the GASB ED, if left unchanged, would require individual employers to record liabilities for pension benefits which they have no legal obligation, contractual or otherwise, to pay.

The Board comments at paragraph 246 that "cost-sharing employers have an ongoing responsibility to financially support the benefits created by their *collective employment exchanges* with their employees." This is not accurate. Any additional obligation imposed on employers beyond the existing statutorily required employer contributions would require legislation.

It is our perspective that the "collective employment exchanges" engendered by a cost-sharing plan is no different than that for the federal Social Security program, Medicare,

or state unemployment benefits. Employment with an entity that participates in a cost-sharing plan only serves to provide *access* to the state-wide pension plan. In the private sector, employers pay a percentage of employee salaries into the Social Security and Medicare programs, but are not responsible for, and do not record, the actuarial liability for future benefits under those programs. The employees receive these benefits by virtue of their employment with the private entity. As participation in the Social Security and Medicare programs is not optional, participation in a state-wide cost-sharing plan is also not optional absent a federal statutory exception. Therefore, the collective employment exchange extends no further than the employer providing access to the state-wide pension plan and paying the annual required contribution to that plan.

It may be that the GASB ED relies on a conceptualization of multiemployer plans borrowed from ERISA. Under ERISA, a multiemployer pension plan established as a cost-sharing arrangement is defined as a plan "to which more than one employer is required to contribute" and "which is maintained pursuant to one or more collective bargaining agreements between an employee organization and more than one employer . . . ." 29 U.S.C. § 1002(37)(A). ERISA imposes a formula for assessing withdrawal liability on multiemployer plans regulated thereunder to achieve Congress' goal of ensuring that employees and their beneficiaries would not be deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds had been accumulated in them. *See, e.g., Concrete Pipe & Products of California, Inc. v. Constr. Laborers Pension Trust for S. California*, 508 U.S. 602, 605, 113 S. Ct. 2264, 2270, 124 L. Ed. 2d 539 (1993). However, governmental plans such as CO PERA are not subject to regulation under ERISA and employees are protected against the risk of employer withdrawal from the plan by statute. The ERISA definition of multiple employer plans is therefore neither a correct nor useful analogy.

The GASB ED would Require Public Entities to Record Liability for Benefit Payments that are not Legally Vested and which may be Reduced by Law.

The extent to which any statute creates a promise that ripens into a vested contractual right under constitutional principles is a question of law. *See, e.g., National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.,* 470 U.S. 451, 465-66, 105 S.Ct. 1441, 1451, 84 L.Ed.2d 432 (1985) ("[A]bsent some clear indication that the legislature intends to bind itself contractually, the presumption is that 'a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise.' "). Federal courts interpreting state and federal pension statutes have held that "a pension granted by a public authority is not a contractual obligation, but is a gratuitous allowance, in the continuance of which the pensioner has no vested right; accordingly, the pension is terminable or alterable at the will of the grantor." *See* 52 A.L.R.2d 437 (1957 & Cum. Supp. 2011). Other courts have held that statutorily created pension benefits promised to public employees by law may be reduced under federal constitutional principles, even where employees are found to have contractual rights, if the reduction in benefits is reasonable and necessary to serve a public purpose. *See, e.g., Robertson v. Kulongoski,* 466 F.3d 1114 (9th Cir. 2006); *Parker v. Wakelin,* 123 F.3d 1 (1st Cir. 1997); *Baltimore Teachers Union v. Mayor and City Council of Baltimore,* 6 F.3d 1012 (4th Cir. 1993); *State of Nev. Employees Ass'n v. Keating,* 903 F.32d 1223 (9th Cir. 1990).

Potential Legal Exposure

As noted above, it is our view that individual employers may not be held legally responsible for payment of pension obligations provided by statute. It is our further view that pension benefits promised by statute may be legally reduced. However, at least one court has relied on GASB statements to determine whether unfunded pension liabilities constitute a debt that violates state constitutional limitations on public debt. *See* [***Orange County case – NEED CITE]***. Because the Colorado Constitution, like many other state constitutions, contains similar limitations on debt, we have some concern that the interpretation in the GASB ED could create unnecessary legal exposure.

Proportionate Share Allocation Concept

When the proportionate share allocation concept is applied to the proprietary funds for full accrual accounting recognition by these funds within the reporting entity, a potentially large unfunded obligation will be required with negative impacts on the unrestricted net asset balance for these funds. In Colorado, school districts that receive USDA child nutrition program funding (such as the National School Lunch Program) are required to report their financial activities within an Enterprise fund. In addition, the Department requires prior approval of any meal price changes being proposed by the school districts.

The reporting of a proportionate share of the collective pension obligation by Colorado school district Food Service Enterprise Funds will cause in the majority of cases significant additional undue financial pressure on these school districts to use their current General Fund resources to subsidize the reporting of any proposed pension liability. This is due to the statutory requirement that no funds shall report an ongoing deficit and that the current Food Service Enterprise Funds are operating with a minimum unrestricted net asset balance after current General Fund subsidizes are applied.

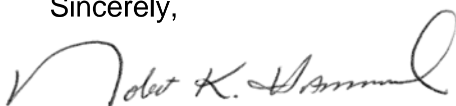
Therefore, the impacts from this proposed treatment of pension obligations by cost-sharing employers will reach beyond the Government-wide and full accrual reporting.

Summary

Disclosure, similar to that provided for in the FASB ED, will provide users of state and local financial statements adequate and transparent insight into the underlying financial condition of the cost sharing plan in which the employer participates. Disclosure would also avoid the pitfalls of recording the net pension liability on individual employers' financial statements.

We appreciate the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Kirk Weber at (303) 866-6610, or at weber_k@cde.state.co.us, Supervisor within the Public School Finance Unit at the Colorado Department of Education.

Sincerely,



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