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Director of Research, Project No. 22-2P
Governmental Accounting Standards Board
401 Merritt 7
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Dear Members of the Board:

Thank you for giving the California Public Employees' Retirement System (CalPERS) the opportunity to comment on your Exposure Drafts of Financial Reporting for Other Post-Employment Benefits (OPEB) by Employers and by Plans.

CalPERS agrees that the general purposes of the Exposure Drafts (assessment of costs of public services and analysis of long-term financial health of government) are important policy goals. At the same time, the proposed reporting standards do not appear to be consistent with the existing GASB concepts statement for use of governmental financial reports. GASB should consider a consistent approach for the use of financial reports before adopting permanent OPEB reporting standards. Consistency with the concepts statement is especially important because the proposed standards will seriously erode the security of retiree health benefits for governmental employees. Because CalPERS and its members will be affected by OPEB financial reporting, CalPERS asks that the Governmental Accounting Standards Board (GASB) consider the comments set forth in this letter.

We have identified a number of inconsistencies, unintended consequences, and unclear definitions in the two Exposure Drafts, that taken as a whole, provide enough rationale for GASB to pause in their quest to implement OPEB accounting standards and reassess the project.

Our comments address the following five issues: 1) issuance of the proposed OPEB accounting standards during a period of financial hardship for government entities will place essential retiree health and other benefits at risk; 2) the proposed standards do not appear to be compatible with the existing GASB Concepts Statement for Use of Financial Reports; 3) the definition of an OPEB Plan for financial reporting purposes requires additional clarification to address all situations and arrangements; 4) the proposed standards have illogical effective dates; and 5) other clarifications.

1) Issuance Of The Proposed Standards Imperils Health Care Coverage For Governmental Employees And Retirees

As trustee for one of the largest health coverage purchasing pools in the nation, the CalPERS Board of Administration strives to provide the public employers and employees who participate in the CalPERS health program with the best possible health coverage for a reasonable cost. The financial and health security of the members of our program is obviously a top priority for CalPERS.

The proposed standards would likely cause a decline in health care and other post-retirement benefits for governmental employees and retirees.[1] If the proposed standards are adopted, governmental employers will be given a strong incentive to reduce or eliminate future health benefits. This might take the form of limiting benefit accruals for existing employees or discontinuance of OPEB benefits to future employees. Based upon the results FAS 106 had on private sector workers a decade ago, it can be anticipated that employer participation in post employment health care programs will undergo a persistent decline. CalPERS is committed to preserving the financial and health security of our members and, as such, we ask that GASB acknowledge the unintended consequences of their proposal and consider modifications that would mitigate any incentive for employers to reduce or eliminate post-retirement benefits.

These consequences are exacerbated by the substantial costs of implementing the proposed standards. In addition to acquiring expensive actuarial services to perform the proposed analysis and calculations, governmental entities must collect, store, and maintain large amounts of data profiling on plan participants and health care cost trends. Currently, much of this information either does not exist or is very difficult to compile. This effort is further complicated by additional security measures mandated by the Health Information Personal Privacy Act (HIPPA).

During this time of diminishing governmental revenues, implementing the proposed standards is an onerous mandate that states, local governments, and public health benefit plans are unable to afford. The State of California, for example, is facing a budget deficit estimated at approximately $35 billion for the next fiscal year.

Simply put, governments and their employees cannot afford the proposed standards. Implementation will cause governments to incur additional expenses during a period of financial strain and could cause a reduction in health and other post-retirement benefits.

2) The Proposed Standards Are Not Consistent With Current GASB Reporting Objectives

CalPERS supports the concept of transparency in financial reporting. But the proposed standards do not appear to be compatible with the existing GASB reporting objectives – Concepts Statement for Use of Financial Reports – and it is unclear whether the proposed standards will ultimately meet these objectives.

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[1] To the extent that public employers in California extend a promise to their employees of paying, as deferred compensation, the costs of retiree health care, this benefit is considered a “vested” contractual right of the employee. The extent of this vested right, however, is not entirely clear under current caselaw.

As part of its First Period – 2003 Technical Plan, GASB is conducting a research project entitled, "Conceptual Framework – Communications." CalPERS understands that the objective of this project "is to clarify the definition of general purpose external financial reporting, to identify and provide definitions of various methods of communicating financial and finance-related information to users, and to develop criteria for using each method."[2] GASB is thus committed to updating the existing financial reporting objectives.

CalPERS recommends that GASB complete this project before issuing the proposed standards. Under the existing GASB Statement of Concepts, it is not clear that the proposed standards fall within the existing Uses of Financial Reports. Paragraph 32 of Concepts Statement No. 1 of the GASB Objectives of Financial Reporting (May 1987) (Concepts Statement) provides that financial reporting is instrumental in "assessing financial condition and results of operations …." In turn, paragraph 34 defines "financial condition" as government's "financial position and its ability to continue to provide services and meets its obligations *as they become due*." (Emphasis added.) Although contingent liabilities are also mentioned in the Concepts Statement, there is no guidance on the types of contingencies that are desirable uses for governmental financial reporting.

The proposed standards are designed, in part, to require disclosure of accrued liabilities of governmental entities – irrespective of whether they are due and owing. Because of this discrepancy, CalPERS recommends GASB explore other interim standards until it identifies and adopts revised governmental reporting objectives.

3) The Definition Of An OPEB Plan Requires Additional Clarification

CalPERS requests that GASB clarify the applicability of the "Plan Exposure Draft" to plans which have pre-funding agreements in place and have received assets earmarked for future retiree health care coverage costs. As currently proposed, Plan financial reporting for "substantive plans" with no assets held in trust, or pay-as-you-go plans will add no additional value to what is already reported in participating employer financial statements. Until pre-funding occurs the Plan administrator/trustee is not providing services or other substantial enhancements to the Plan.

Specifically, we recommend GASB amend **Plan Exposure Draft, paragraph 4**, to include a requirement that an actual transfer of resources from a participating employer to the plan trustee for future retiree health costs must occur before a plan is required to prepare the proposed OPEB financial statements. We also recommend amending **paragraph 61** to delete the phrase – "and regardless of how a plan is funded or financed" - and replace the deletion with wording similar in intent to that suggested for paragraph 4.

4) Proposed Implementation Dates Are Irrational

The proposed implementation dates are not rational. As proposed, large governments with more complex OPEB plans will have the most difficulty gathering and analyzing the necessary data to report, yet they are the first group required to implement the proposed standards.

[2] This information was gleaned from the GASB website.

In contrast, smaller governments with less complex plans and less technical reporting requirements will have a longer time period to prepare for implementation. Additionally, "Plans" as defined in the Exposure Draft must implement the proposed standards before participating employers. We urge GASB to discuss implementation problems with affected governmental entities and reevaluate their proposed implementation strategy.

5) Other Clarifications

CalPERS agrees with the GASB proposal to exempt employers from reporting implicit rate "subsidies" when retirees are allowed to participate in an employer sponsored Plan but pay their full premium. Separately identifying rate subsidies is contrary to accepted insurance pooling theory and could lead to inter-generational divisiveness that could imperil benefits offered to all. However, CalPERS asks that GASB clarify the proposal by eliminating the term, "subsidy." A risk pool, like an insurance pool, is not a subsidy; rather, both are designed to spread risk.

Conclusion

CalPERS supports the concepts of pre-funded retirement benefits and transparency in financial disclosure. For the reasons explained above, the current proposed standards raise far more issues than they will solve. CalPERS asks that GASB carefully consider the impact of the issues we have raised. A consensus from affected parties on these issues should be achieved and incorporated into OPEB accounting standards before they are issued.

Thank you for providing us with this opportunity to communicate with GASB our thoughts on an issue important to governments, taxpayers, and employees.

Sincerely,

Vincent P. Brown
Deputy Executive Officer, Operations
California Public Employees' Retirement System