Federal Accounting Standards Advisory Board

January 31, 2008

TO: Members of FASAB

FROM: Richard Fontenrose, Assistant Director

THROUGH: Wendy Payne, Executive Director

SUBJECT: Tab E – Exposure Draft *Reporting Gains and Losses from Changes in Assumptions and Selection of Discount Rates and Valuation Dates*: Comment Letters Received through January 31, 2008[1]

MEETING OBJECTIVES

The staff objective for February 14th is to review the comments received to date, begin the discussion of issues identified, and decide whether a public hearing would be productive.

BRIEFING MATERIAL

This Tab presents the seven responses received as of January 31, 2008, regarding the exposure draft *Reporting Gains and Losses from Changes in Assumptions and Selection of Discount Rates and Valuation Dates* ("the ED"), as well as the staff's comments and recommendations on certain issues it has identified.

The Attachments are as follows:

Attachment 1 – The exposure draft issued August 3, 2007.
Attachment 2 – A PDF file of comment letters received
Attachment 3 – Staff Summary of Responses
Attachment 4 – Staff Analysis

Attachment 3, the staff summary of responses, presents three tables as follows:

a. Table 1 – A Tally of Responses by Question,
b. Table 2 – A Quick Table of Responses by Question, and
c. Table 3 – A detailed table of Answers and Comments by Question and by Respondent, and

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Attachment 3, Table 3, identifies four broader issues as well as other, relatively minor suggested changes from respondents. The staff's plans to accommodate the latter are identified in the Attachment 3, Table 3, as changes to be made "without objection from members at the meeting on February 14th", and, without objection, the staff will develop the details for these changes for the Board's consideration at a subsequent meeting.

In Attachment 4 of this memorandum staff develops the four broader issues and offers recommendations on each for the Board's consideration, as well as providing a brief overview of the responses.

BACKGROUND

The ED proposed standards for reporting gains and losses from assumption changes as discrete line items on the statement of net cost; for disclosing information about the components of certain expenses associated with long-term liabilities and about current market rates for Treasury securities; and for selecting discount rates and valuation dates. This statement would be effective for fiscal years beginning after September 30, 2008.

SUMMARY OF OUTREACH EFFORTS

The ED was issued August 7, 2007, with comments requested by November 30. Upon release of the ED, notices and press releases were provided to:

a. The Federal Register;
b. *FASAB News*;
c. The *Journal of Accountancy*, *AGA Today*, *The CPA Journal*, *Government Executive*, *The CPA Letter*, and *Government Accounting and Auditing Update*;
d. The CFO Council, The President's Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council; and
e. Committees of professional associations generally commenting on EDs in the past.

To encourage responses, a reminder notice was posted electronically in mid-November to our Listserv. In addition, we extended the comment period from November 30 to January 15 on November 28, and provided reminder notices to our liaison groups in the community.

The Board normally keeps the window open for comments as long as possible. We will provide copies and analysis of any comments subsequently received.

RESULTS

As of January 31, 2008, we have received seven responses from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	1	
Preparers and financial managers	4	

The comment letters, which are provided in Attachment 2, identify respondents in the order their responses were received.

STAFF SUMMARY AND ANALYSIS

Staff has summarized and analyzed the questions as described above. The usual caveat applies: the staff intends for the summary to support your consideration of the comments and the members are aware that it is not a substitute for reading the individual letters.

Should you have questions or concerns or for any reason wish to discuss the responses or any other subject please call me (202-512-7358

ATTACHMENT NO. 1

FASAB

Federal Accounting Standards Advisory Board

Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by November 30, 2007

August 3, 2007

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at www.fasab.gov.

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August 3, 2007

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled *Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*. Specific questions for your consideration appear on page 3 but you are welcome to comment on any aspect of this proposal. Your response would be more helpful to the Board if you explain the reasons for your position, whether you favor the proposal or not; and any alternative you propose. Responses are requested by November 30, 2007.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to comesw@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street NW, Suite 6814
Washington, DC 20548

The Board’s rules of procedure provide that it may hold one or more public hearing on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB newsletter.

Tom Allen
Chairman

Executive Summary

What is the Board proposing?

This proposed statement provides standards for displaying the gains and losses from changes in assumptions as a discrete item on the statement of net cost, for certain note disclosures, and for selecting discount rates and valuation dates for present value measurements of expense and liability amounts.

Why is the Board making this proposal?

Displaying gains and losses from changes in assumptions as discrete line items on the statement of net cost will enhance the usefulness of the information provided on the statement of net cost. Separate display will highlight the effects of changes in assumptions, which can be significant. Expenses assigned to programs will be distinguished from the gains and losses from changes in assumptions. The user will be better able to understand the operating performance of the entity as well as the role of gains and losses from changes in assumptions.

In addition to the display issue, there has been uncertainty in practice regarding which U.S. Treasury rates should be used for discount rates for present value measurements of expense and liability amounts. Current guidance can be interpreted in various ways.

Also, guidance for selecting the valuation date for such programs is in need of codification.

How does this proposal improve Federal financial reporting?

A separate display of gains and losses from changes in assumptions on the statement of net cost would allow users of financial statements to see the effect of gains and losses from changes in assumptions. Also, the required note disclosure of the component's costs will provide detailed information about such costs for analysis. This proposed statement also would provide needed guidance for selecting discount rates and valuation dates.

How does this proposal contribute to meeting Federal financial reporting objectives?

The revised standard will result in more transparent and useful information prepared in a more consistent manner that will improve the ability of readers to assess operating performance and stewardship.

Table of Contents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses to the Request for Comments questions should be sent by e-mail to comesw@fasab.gov. If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by November 30, 2007.

Questions for Respondents

Display and Disclosure

Q1. This statement proposes to display gains and losses from changes in assumptions, including the discount rate assumptions, as a discrete item on the statement of net cost. See paragraphs 19-26 in the standard, paragraphs A1-A10 in the basis for conclusions, and the illustration in Appendix B, "Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions," for more information regarding display and disclosure.

1.1 Do you believe that the display will be informative?

1.2 Do you believe the standard provides satisfactory guidance as to what should be displayed as gains or losses from changes in assumptions?

Please provide your rationale in as much detail as possible.

Q2. The statement also proposes that the components of the expense associated with long-term liabilities be disclosed in notes to the financial statements. See paragraphs 22 and 26 in the standard, paragraph A9 in the basis for conclusions, and the illustration in Appendix C, "Pro Forma Note Disclosure of Liabilities and Expense," for more information regarding display and disclosure.

Do you believe that disclosure of the components of expense is informative? Please provide your rationale in as much detail as possible.

<u>Selecting the Discount Rate Assumption</u>

Q3. This statement proposes that the preparer provide the 10-, 20- and 30-year market rate for Treasury securities in the notes to the financial statements as a benchmark comparison with the discount rate used by the entity. See paragraph 24 for the note disclosure standard and paragraph A10 in the basis for conclusions for the rationale for the disclosure of market rates.

Do you believe that disclosure of market rates as described above is informative? Please provide your rationale in as much detail as possible.

Q4. The statement addresses long-term assumptions that have a material effect on the reporting, for example, those used for measuring expense and liabilities associated with pensions, other retirement benefits, and post-employment benefits. The statement excludes short-term assumptions of which it provides specific examples (see paragraph 20.A), and defines "long-term assumptions" as those involving projections of 5 years or more (see paragraph 15) and, accordingly, short-term assumptions as those involving projections of fewer than 5 years.

4.1 Do you believe that the 5-year division between short- and long-term assumptions is appropriate?

4.2 Do you believe the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement is appropriate?

4.3 Are "short-term assumptions" clearly delineated?

4.4 Should other short-term assumptions be listed as examples?

Please provide your rationale in as much detail as possible.

Q5. This statement proposes a standard for selecting the discount rates for present value measurements of expense and liability amounts. The standard provides that the discount rate should be the interest rate(s) on **marketable Treasury securities** of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rate(s) should reflect average historical rates on marketable Treasury securities rather the current market rate(s). See paragraphs 27-28 in the standard and paragraphs A11-A35 and especially A28 in the basis for conclusions.

5.1 Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?

5.2 How would you interpret the word "historical" in the phrase "average historical Treasury rates," for example, a 1-year average? 5-year average? 20-year average?

5.3 The proposed standard incorporates prior FASAB guidance regarding selecting economic assumptions. It invokes Actuarial Standards of Practice and does not affect the explicit SFFAS 5 requirement for consistency among assumptions. See ED paragraphs 33, which contains revisions to relevant SFFAS 5 paragraphs. Some observers advocate expanding the scope of the standard to provide for selecting all economic assumptions because they are concerned about consistency between the discount rate and other economic assumptions employed. Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph 33 of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions?

Please provide your rationale in as much detail as possible.

<u>Selecting the Valuation Date</u>

Q6. This statement proposes a standard for selecting the valuation date for present valuations for long-term liabilities. See paragraphs 30-32 in the standard and paragraphs A36-A44 in the basis for conclusions.

Do you believe the valuation date approach is appropriate? Please provide your rationale in as much detail as possible.

<u>Reasonable Estimate vs. Best Estimate</u>

Q7. This statement involves estimates that reflect the preparer's judgment about the outcome of events based on past experience and expectations about the future. Estimates are to reflect what is reasonable to assume under the circumstances rather than the preparer's "best estimate" or other phraseology. The preparer may use his or her own assumptions about future cash flows. However, the entity should explain why it is inappropriate to use assumptions generally used in the federal government, as evidenced by independent sources, if the assumption the entity used is different. See paragraph 32 in the standard and paragraphs A43-A44 in the basis for conclusions.

Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate? Please provide your rationale in as much detail as possible.

Benefits and Costs

Q8. The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal.

Please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal in whole or in part. Please provide your rationale as much detail as possible.

Introduction

Purpose

1. This standard requires the following:

    A. gains and losses from changes in assumptions displayed on the statement of net cost separately from other costs and exchange revenue. This display will distinguish or provide more transparent information regarding the underlying costs associated with certain liabilities.

    B. components of the expense associated with long-term liabilities disclosed in notes to the financial statements. Such disclosure will provide useful information for analytical purposes. The information will be comparable across agencies and between post-employment and retirement programs.

2. This standard also provides guidance for selecting:

    A. the discount rates used in present value measurements of expense and liability amounts. There is currently uncertainty in practice regarding the discount rates in some situations.

    B. the valuation date for certain present valuations associated with long-term liabilities, which will establish a consistent method for such measurements.

Background

Reporting Gains and Losses from Changes in Assumptions

3. During its discussions on long-term obligations the Board addressed the need to highlight gains and losses from changes in assumptions in Federal financial reports. The largest amounts on the statement of net cost for the Financial Report of the United States Government (FR)[1] and for the certain component entities can result from gains and losses from changes in assumptions. The Board is now requiring that such gains and losses be reported as a discrete line item on the statement of net cost.

Selecting the Discount Rates

4. Statement of Federal Financial Accounting Standards (SFFAS) 5 provides standards for several types of liabilities, some of which require present value valuations. Federal accounting standards requiring present valuations usually specify U. S. Treasury borrowing rates as the discount rates, although the terminology used differs.

5. With respect to the selection of assumptions, including the discount rate assumption, SFFAS 5 emphasizes expected long-term future trends rather than recent past

[1] See Appendix D containing Note 11, ”Federal Employee and Veterans Benefits Payable,” from the FY 2006 FR.

experience. For the discount rate, SFFAS 5 requires either the entity's long-term investment yield on assets, if the benefit plan is being funded, or other **long-term assumptions**[2] such as Treasury borrowing rates for securities of similar maturity to the period over which the payments are to be made.[3]

6. Some entities have interpreted the SFFAS 5 standard with respect to **other post-employment benefits** (OPEB) to require the use of single-day Treasury rates for the discount rates. Single-day rates render liability projections susceptible to more volatility than, for example, rates based on long-term expectations or historical experience.

7. Liabilities for post-employment and retirement benefits and other long-term Government obligations can be very large. The combination of the magnitude of these liabilities and volatility of the projections has resulted in large variations in annual cost from year to year that reduce the usefulness of reported operating results.

8. When they require long-term Federal Government borrowing rates or Treasury borrowing rates for discounting, FASAB standards do not specify a precise method for selecting those rates. There are a number of options for the discount rate.

9. This statement provides guidance with respect to selecting discount rates for present value measurements of expense and long-term liability amounts.

Selecting the Valuation Date

10. This statement provides guidance regarding selecting valuation dates for present valuations. Few FASAB standards currently address the valuation date per se.

11. In Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* (August 1997), the Board addressed the valuation date issue with respect to measuring Federal civilian and military employee pensions and retirement health care liabilities in general purpose financial reports prepared pursuant to SFFAS 5. Interpretation 3 requires that pension and retirement health care liabilities in general purpose Federal financial reports prepared pursuant to SFFAS 5 be measured as of the end of the reporting period. However, a full actuarial valuation as of the end of the reporting period is not required. The Interpretation allows the measurement to be based on an actuarial valuation performed as of an earlier date during the fiscal year, including the beginning-of-year, adjusted or "rolled forward" for the effects of changes during the year in major factors such as pay raises and cost of living adjustments.

12. In this statement the Board is extending the Interpretation 3 approach to expense and liability measurement for long-term liabilities, including OPEB.

13. This statement would be effective for fiscal years beginning after September 30, 2008.

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[2] Terms in the Glossary are shown in **boldface** the first time they appear in this document.
[3] SFFAS 5, pars. 66, 83, and 95.

Proposed Accounting Standard

Scope

14. This statement applies to liabilities that employ long-term assumptions, unless FASAB standards specifically provide otherwise. The long-term estimates on which the Board is focusing frequently employ discounted present value and therefore a discount rate assumption. However, the entity is required to display the effect of changes in long-term assumptions even if discounted present value is not employed. The following are examples of some of the activities within the scope of the standard:

    A. Federal civilian and military employee pensions, other retirement benefits (ORB), and other post-employment benefits (OPEB), including veterans' compensation;[4]
    B. Environmental clean-up obligations;
    C. Guarantees other than loan guarantees, e.g., pension guarantees;
    D. Insurance obligations: and
    E. Contingent liabilities for which the confirming event is 5 years or more in the future.

15. For the purpose of this statement, assumptions are considered **long-term assumptions** if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events, for example, environmental clean-up payments, the entire series should be considered the event and, thus, projected payments may commence within one year but would be required to extend at least five years. Otherwise, assumptions would be considered short-term.

16. The statement does not apply to certain long-term liabilities or allowances on losses where the FASAB has specifically provided standards. Thus, the statement does not apply to areas addressed in SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, SFFAS 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees (Amends SFFAS 2),* and SFFAS 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees (Amends SFFAS 2)*.

17. In addition, except for the change in terminology to characterize the preparer's long-term estimates from "best estimate" to "reasonable estimate," the statement does not apply to social insurance programs for which the FASAB has specifically provided standards in SFFAS 17, *Accounting for Social Insurance*. The preparation and display of the expense and liability, related disclosures, and the statement of social insurance follows the standards promulgated in SFFASs 17, 25,[5] and 26.[6]

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[4] The pension program for veterans of the Department of Veterans' Affairs (DVA) is not accounted for as a "Federal employee pension plan" under SFFAS 5 and the obligation therefore is not recorded as a liability due to differences between its eligibility conditions and those of Federal employee pensions. The veterans' pension obligation is currently measured internally by the DVA in a manner consistent with the DVA's compensation program.

[5] *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessments*, July 17, 2003.

18. The statement applies to information provided in general purpose Federal financial reports. It does not affect statutory or other special-purpose reports.

Display

Component Entities

19. Component entities should display gains and losses from changes in long-term assumptions used to measure liabilities as a separate line item or line items on the statement of net costs. See the pro forma illustration in Appendix B.

20. The display requirement in paragraph 19 does not apply to changes in the following assumptions:

    A. assumptions that are short-term in nature, for example, those used to estimate receivables, payables, and inventory and related property; and
    B. assumptions used in direct loan and loan guarantee programs or other activities for which the FASAB has provided specific display, discount rate, or valuation date standards.

21. Selecting the long-term assumptions for which gains and losses from changes are to be displayed individually on the statement of net cost requires judgment. The preparer should consider quantitative and qualitative criteria. Acceptable criteria include but are not limited to quantitative factors such as the percentage of the reporting entity's cost that resulted from changes in assumptions; and qualitative factors including whether the gains or losses from changes in an assumption should be of interest to decision-makers and other users.

22. Component entities should disclose in notes to the financial statements the following reconciliation of beginning and ending liabilities:

[6] *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, November 1, 2004.

Beginning liability balance	$X,XXX
<u>Expense:</u>	
Service cost[*]	XX
Interest on the liability balance	XX
Actuarial (gain)/loss:	
From experience	XX
From assumption changes	XX
Prior service costs[*]	X
Other	(X)
Total expense	XXX
Less amounts paid	(XX)
Ending liability balance	$X,XXX

23. This reconciliation must provide <u>all</u> material components of expense consistent with the components identified above, if applicable. Additional sub-components may be presented. The line item for **actuarial gains and losses** should be broken out into the sub-components “from experience” and “from assumptions changes.” Separate columns should be presented for each liability line item that contains a balance subject to reporting under this standard, e.g., a contingent liability balance within the line item “other liabilities.” Similarly, significant programs or types of activities (e.g., pensions, retirement health care, and OPEB) should be presented individually in a separate column along with an “all other” column, if applicable, and a “total” column for each line item. Selecting programs or activities to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity’s liabilities; and qualitative factors such as whether the components of a

[*] See the glossary for this standard’s definition of “service cost.” The term “service cost” is used in paragraph 22 (and in Appendix C) for illustration only. The term "service cost” is often associated with benefit programs, e.g., pension and other retirement benefits, because service to the employer performed during the period increases the liability. Note, however, that "service cost" as defined in the glossary could apply to non-benefit programs that incur long-term liabilities. For this standard, “service cost” is defined as the "actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period." This is the same as the glossary definition of “annual cost increment.” In short, the entity would not be required to use “service cost” as a descriptor for the line item that contains the annual cost increment.

Moreover, some liabilities are measured using nominal values rather than present values, e.g., environmental liabilities pursuant to SFFAS 6, *Accounting for Property, Plant, and Equipment*. The illustration in paragraph 22 (and Appendix C) includes a line item entitled "interest on the liability balance." Such a line item would be appropriate in instances where present valuation is employed for the liability estimate. However, if present valuation is not used, no interest on the obligation is recognized and there would be no need for such a line item. In such instances, the line items for the note disclosure would include, for example, the nominal value of the annual cost increment, the actuarial gains and losses attributable to changes in assumptions (other than the discount rate) employed in the estimate, and possibly other line items.

liability are of concern to beneficiaries, or whether the information provided in the note disclosure would be of interest to decision-makers and other users.

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24. Component entities should disclose current market rates as of the reporting date for Treasury securities with 10-, 20-, and 30-year maturities, if available, for comparison with the average historical rate the entity is using for the discount rate.

Governmentwide Entity

25. The Governmentwide entity should display gains and losses from changes in assumptions as a separate line item or line items on the statement of net cost after a subtotal for all other costs and before total cost. See the pro forma illustration in Appendix B.

26. The Governmentwide entity should disclose in the notes to the financial statements a reconciliation consistent with paragraph 22 above for long-term liabilities. At a minimum, reconciliations for liabilities classified as civilian, military, and veterans OPEB must be presented. See Appendix C for an example.

Selecting Discount Rates

27. Discount rates for present value measurements of long-term liabilities should be interest rates on **marketable Treasury securities** of similar maturities to the cash flows of the payments for which the estimate is being made, unless the discount rate is specifically provided in other FASAB standards. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which payments are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the result is not materially different than the multiple-rate result.

28. The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The preparer will need to exercise judgment when developing the discount rate.

29. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.

Selecting Valuation Date

30. Estimates of liability and expense in general purpose Federal financial reports should be measured as of the end of the fiscal year (or other reporting period if applicable). Measurements based on an actuarial valuation may be performed as of an earlier date during the fiscal year, including the beginning of the year, with adjustments for the

effects of changes during the year in major factors such as the pay raise and cost of living adjustment. This measurement is required to be performed following the end of the period reported, but a full actuarial valuation as of the end of the reporting period is not required.

31. The valuation date utilized by the entity should be consistently followed from year to year.

32. Measurements should reflect the entity's assumptions about the major factors that would be reflected in a full actuarial valuation, such as the actual pay raise, the actual cost of living adjustment, and material known changes in the number of participants covered (enrollment) that cause a change in the liability. The entity's estimates will reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates should reflect what is reasonable to assume under the circumstances. The entity's own assumptions about future cash flows may be used. However, the entity should review assumptions used generally in the Federal Government as evidenced by independent sources, for example, those used by the Federal Bureau of Economic Analysis for the National Income and Product Accounts and, if its assumptions do not reflect such data, explain why it is inappropriate to do so.

Effect on Prior Standards

33. This statement provides additional requirements for display, disclosure, discount rates, and valuation dates and replaces "best estimate" with "reasonable estimate" for Federal long-term liabilities, including Federal civilian and military employee pensions, ORB, and OPEB in SFFAS 5. Interpretation 3 is rescinded.

SFFAS 5

34. This statement also affects current standards for selecting discount rates. SFFAS 5, *Accounting for Federal Liabilities*, is amended as follows:

> *65.* ***Assumptions****—For financial reports prepared for the three primary federal plans (CSRS, FERS, and MRS),~~ the best available~~ actuarial estimates of assumptions should be used to calculate the pension expense and liability. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice No. 4, Measuring Pension Obligations, as revised from time to time by the Actuarial Standards Board. Accordingly, actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long term future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.* [footnote omitted]

> *66. In addition to complying with the guidance in the preceding paragraph,* ***<u>the discount rate assumption for present value measurements of long-term liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which payments are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the result is not materially different than the multiple-rate result.</u>*** *~~the interest rate assumption should be based on an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term Federal government borrowing rate)~~. The underlying inflation rate and the other economic assumptions should be consistent. ~~The rate used to discount the pension obligation should be equal to the long-term expected return on plan assets.~~* ***<u>The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The preparer will need to exercise judgment when developing the discount rate. For cash flows that are projected to occur in future years for which</u>***

Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.

83. ***Assumptions****—Amounts calculated for financial reports prepared for ORB plans should reflect (1) general actuarial and economic assumptions that are consistent with those used for* ***Federal employee*** *pensions and (2) a* ***long-term*** *health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The* ***discount rate assumption for present value measurements of long-term liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which payments are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the result is not materially different than the multiple-rate result*** ~~*be equal to the long-term expected return on plan assets if the plan is being funded or on other long-term assumptions (for example, the long-term Federal government borrowing rate) for unfunded plans.*~~ ***The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The preparer will need to exercise judgment when developing the discount rate. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.*** *The administrative entity should disclose the assumptions used.*

95. The employer entity should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. For example, a reduction in force may require an employer entity to make severance payments, unemployment reimbursements, or other payments in future periods. Similarly, an injury on the job may require the employer entity to make short- or long-term reimbursements to the Federal workers' compensation program. A long-term OPEB liability should be measured at the present value of future payments. This will require the employer entities to estimate the amount and timing of future payments, and to discount the future outflow using the ***interest rate on marketable*** *Treasury* ~~*borrowing rate for*~~ *securities of similar maturit****ies*** *to the period over which the payments are to be made.* ***The discount rate assumption for present value measurements of long-term liabilities***

> ***should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which payments are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the result is not materially different than the multiple-rate result. The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The preparer will need to exercise judgment when developing the discount rate. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.***

> *157. Second, assumptions ought to be consistent across federal employee retirement systems. Assumptions need not be identical because the conditions facing each plan may objectively differ, but they should be rationally related (thus, the standard calls for financial reports to be prepared on the basis of ~~the best available~~* ***reasonable*** *estimates for actuarial assumptions). Also, the standard allows the smaller plans to use the assumptions provided by any of the three primary plans or to use their own assumptions if they explain how and why they are different from one of the major plans.*

SFFAS 7

35. This statement also affects current standards that use the term "best estimate." SFFAS 7, *Accounting for Revenue and Other Financing Sources …*, is amended as follows:

> *67.1 Entities that collect taxes and duties should provide the following supplementary information relating to their potential revenue and custodial responsibilities:*
>
> > *67.1 The estimated realizable value, as of the end of the reporting period, of compliance assessments and, if reasonably estimable, preassessment work in process. The amounts furnished should represent management's ~~best~~ estimate of additional revenues* ***reasonably expected*** *~~likely~~ to be collected from compliance assessments and from pre-assessment work in process, appropriately qualified as to their reliability. A range of amounts may be provided for pre-assessment work in process if estimable. The change in the total(s) of compliance assessments and of pre-assessment work in process during the reporting period also should be provided.*

> *67.2 If reasonably estimable, other claims for refunds that are not yet accrued but are likely to be paid when administrative actions are completed. If estimated, unasserted claims for refunds should be provided separately from claims filed and may be expressed as a range of amounts. The amounts furnished should represent management's ~~best~~ **reasonable** estimate~~s~~, appropriately qualified as to their reliability. The change in the total of these amounts during the reporting period also should be provided.*

SFFAS 17

36. Paragraphs 24-27 and 32-33 of SFFAS 17 provide the standard for required supplementary information (sub-paragraph 27(3) and 32(3) were re-classified as basic information by SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*). Paragraph 25 of SFFAS 17 is changed as follows:

> *25. The projections and estimates used should be based on the entity's ~~best~~ **reasonable** estimates of demographic and economic assumptions, taking each factor individually and incorporating future changes mandated by current law. Significant assumptions should be disclosed.*

37. Paragraph 27(2) of SFFAS 17 requires the ratio of contributors to beneficiaries as supplementary information. Paragraph 27(2) is changed as follows:

> *27(2) Ratio of Contributors to Beneficiaries - With respect to the OASDI and HI programs, the ratio of the number of contributors to the number of beneficiaries (commonly called the "dependency ratio") during the same projection period as for cashflow projections (e.g., 75 years), using the program managers' ~~best~~ estimate. At a minimum, the ratio should be reported for the beginning and end of the projection period*. [footnote omitted]

38. Paragrapoh 27(4)(a) of SFFAS 17 requires sensitivity analysis as supplementary information. The phrase "best estimate cost" before the word "assumptions" is changed as follows:

> *27(4)(a) For all programs except UI illustrate the sensitivity of the projections and present values required by paragraphs 27(1) and 27(3) to changes in the most significant individual assumptions. For example, using the entity's ~~"best estimate"~~ **reasonable** cost assumptions as a baseline, show the effect of varying several significant assumptions ….*

Effective Date

39. This statement is effective for fiscal years beginning after September 30, 2008.

> The provisions of this statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

<u>Display</u>

A1. During its recent consideration of long-term obligations the Board discussed how financial statement display might be modified to show the fluctuations in cost caused by changes in assumptions. The largest amounts on the operating statement for the Financial Report of the United States Government (FR) and on the statement of net cost for some component entities often result from gains and losses from changes in assumptions. Note 11[7] to the FY 2006 FR disclosed that the expense for military employee pension benefits was $112.2 billion. Of this amount $20.1 billion was for changes in assumptions, and $6.1 billion was from differences between actual experience and what was assumed. And even more dramatically, Note 11 in the FR for FY 2005 disclosed that of the $123 billion expense for post-retirement healthcare benefit for military personnel, $53 billion is attributed to changes in assumptions and $5 billion was from differences between actual experience and what was assumed.

A2. The Board decided to develop a general standard because many programs are affected by changes in long-term assumptions. Such programs involve long-term liability and cost estimates the dollar amounts of which are very large relative to other financial statement items. The long-term estimates on which the Board is focusing frequently employ discounted present value and therefore a discount rate assumption. However, the entity is required to display the effect of changes in long-term assumptions even if discounted present value is not employed

A3. In its pension standard for the private sector, Statement of Financial Accounting Standards (SFAS) 87, *Employers' Accounting for Pensions*, and its standard for other postretirement benefits standard, FAS 106, *Employers Accounting for Postretirement Benefits*, the Financial Accounting Standards Board (FASB) did not require recognition of **actuarial gains and losses** as components of net pension cost of the period in which they arise. The FASB reasoned that such costs may reflect refinements in estimates as well as real changes in economic values and that some gains in one period may be offset by losses in another or vice versa. Thus, the current FASB standard requires such costs to be amortized over the future service of those employees active at the date of the amendment that are expected to receive benefits under the plan. The resulting "smoothing" effect of such amortization has been controversial. The FASB has recently added a pension project to its agenda to re-consider this approach.

[7] See Appendix C for Note 11.

A4. In September 2006, the FASB published a new standard on pensions and postretirement benefits, FAS 158, entitled *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88,132R*, as Phase I of the pension project. The FASB noted that delayed recognition of actuarial gains and losses is often the principal reason why the over- or under-funded status of postretirement benefit plans were not recognized in the sponsoring employer's statement of financial position. FAS 158 requires actuarial gains and losses that have not been recognized as a component of net periodic benefit cost to be recognized as increases or decreases in other comprehensive income and adjusted as they are subsequently recognized as a component of net periodic benefit cost based on the amortization and recognition requirements of Statements 87 and 106.

A5. The FASAB concluded in SFFAS 5, *Accounting for Liabilities of the Federal Government*, that actuarial gains and losses, including those from changes in assumptions, are expenses that should be recognized immediately, without amortization. Thus, SFFAS 5 requires recognition of such gains and losses as a component of expense in the period in which they arise. The FASAB continues to believe that nothing is gained by delaying recognition of a cost and a liability or by reducing volatility and "smoothing" operating results.

A6. This statement requires that gains or losses from changes in assumptions, if any, should be presented as discrete line items not assigned to programs on the statement of net cost. The Board believes that this disaggregation will enhance the usefulness of the information provided on the statement of net cost. Separate display will highlight the effects of changes in assumptions, which can be significant. Expenses assigned to programs will be distinguished from the gains and losses from changes in assumptions. The user will be better able to understand the operating performance of the entity as well as the role of gains and losses from changes in assumptions.

A7. The Board believes that the discrete display of such gains and losses will enhance users' understanding of liabilities and periodic expense. Users, including entity managers, will understand more about how liabilities and expense are measured; about the uncertainty of the measurement of individual liabilities; and about what causes changes in liabilities. Managers will benefit from having information about the volatility of assumptions in long-term programs. Extreme volatility might indicate the assumptions chosen and/or the assumption-selection process needs re-evaluation. Volatility may affect the entity's funding requests and long-term planning. It will at least raise a flag for further investigation.

A8. The statement provides certain exceptions to the display requirement. Assumptions used to estimate receivables, payables, inventory and related property and other short-term assumptions are excepted because they will be proved or disproved within a relatively short period of time. Also, those assumptions used for direct loans and loan guarantees are excepted because the FASAB has already provided accounting procedures.

Note Disclosures

A9. The display standard requires certain note disclosures. First, the components of expense associated with long-term liabilities are to be disclosed. The Treasury Department and other users advocate a disclosure that will allow increased comparability between Federal civilian and military employee and veteran benefits programs. The Board believes that disclosing the components of expense will provide information about the Government's annual accrued costs and about increases and decreases in the associated liability that will be useful for decision-making. The Treasury Department prepares the FR and must explain any wide swings in long-term liabilities. For some time Treasury has sought to improve the disclosure for Federal employee and veteran benefits payable and currently discloses the information shown in Appendix D. The desire for more transparency in this regard is not only the goal of the Treasury Department but also apparent in comments from other FR users, most notably the Federal Reserve. Most of the information required in this statement is already presented in the FR but some data is missing. The Board seeks to fill these gaps with this proposed standard.

A10. The second note disclosure requirement is for market rates for Treasury securities with 10-, 20-, and 30-year maturities, if available. The Board believes that market rates will be a useful benchmark for comparison with the discount rate(s) the entity is using. The discount rate affects expense and liability amounts and a comparison with market rates will provide useful context. The Board considered but decided not to require the note disclosure to include the entity's analysis of the effect on expense and liability amounts of using current market rates. The burden of such a requirement on preparers was deemed to outweigh the benefits of the information provided. However, the note disclosure would allow interested parties to begin such an analysis.

Selecting Discount Rates

A11. The Board became aware of an issue affecting preparers with respect to the selection of discount rates for present value measurements of expense and liability amounts. A preparer noted that, with respect to OPEB accounting, SFFAS 5 requires that the liability be estimated using as the discount rate the U. S. Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.[8] The preparer asked whether the discount rates should be based on a single day's interest rates or whether there are other alternates acceptable, such as an average of interest rates over a period of time. The preparer currently uses one-day Treasury "spot" rates consistent with the expected timing of future cash flows relating to the program, believing that that is what the Board intended by the OPEB standard in SFFAS 5, paragraph 95. As a result, its future liabilities projection is susceptible to more volatility than alternative discounting measures. The preparer has been criticized for extreme volatility in its liabilities projection and has suggested that alternatives to single-day Treasury borrowing rates could mitigate volatility.

[8] SFFAS 5, par. 95.

A12. Several current FASAB standards require present valuations and discounting, including Federal civilian and military employee pensions, ORB, OPEB, and veterans' compensation. Federal activities that incur long-term liabilities typically involve similar types of demographic and economic assumptions.

A13. The FASAB standard for Federal civilian and military employee pensions and ORB includes general guidance with respect to assumptions.[9] These standards state that Federal pension plans should be guided by Actuarial Standards of Practice (ASOP), e.g., ASOP 4, *Measuring Pension Obligations*, and ASOP 27, *Selection of Assumptions for Measuring Pension Obligations*, as revised from time to time by the Actuarial Standards Board (ASB). The ASB is a board associated with the American Academy of Actuaries that sets professional standards of actuarial practice in the United States. The Board referenced ASB standards because it considers them accepted actuarial practice.

A14. Consistent with ASOPs, SFFAS 5, paragraph 65 requires actuarial assumptions to be based on the actual experience of the covered group and to emphasize expected long-range future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the standard requires that the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.

A15. With respect to discount rates for pensions and ORB accounting, SFFAS 5 requires the interest rate used for discounting to be based on

> an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term federal government borrowing rate). …[10]

A16. The FASAB standard for OPEB differs somewhat from that for pensions and ORB. For OPEB, SFFAS 5 requires employer entities to estimate the amount and timing of future payments and to discount the future cash flows using the Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.[11] This difference is attributable to the fact that, unlike most Federal civilian and military employee pensions and ORB plans, the Federal employee OPEB plans generally are not funded and thus the long-term yield on investments was not thought to be relevant. For plans that are not funded the standards have been essentially the same: the objective is an expected long-term rate that reflects the Government's expected borrowing costs.

A17. The Board concluded in SFFAS 5 that the discount rate for pensions and ORB, which are funded, should reflect the long-term expected return on plan assets. The Board explained that the expected long-term rate reduces volatility, reflects the actual

[9] See SFFAS 5, pars. 65 and 83, respectively, for pensions and ORB.
[10] SFFAS 5, par. 66.
[11] SFFAS 5, par, 95.

experience and expectations of the primary Federal plans, and is consistent with the assumptions used in the budget.[12]

A18. The Government Accounting Standards Board (GASB) used a similar approach in Statement 27, *Accounting for Pensions by State and Local Employers*, and Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Discount rates should be based on an estimated long-term investment yield for the plan, with consideration given to the nature and mix of current and expected plan investments and the basis used to determine the actuarial value of assets.[13] The GASB believed that that rate is consistent with the long-term nature of governmental pension plans and should be required for governmental accounting for pensions.[14]

A19. Because most state and local governmental OPEB plans currently are not funded and therefore have few or no plan assets, the GASB considered a number of potential approaches to the selection of a discount rate for OPEB benefits for Statement 45. The GASB concluded that, for consistency, the same principle applied in the pension standards should be applied to OPEB. However, GASB decided to state the principle more broadly in Statement 45 and required the use of the expected long-term yield on the investments that are expected to be used to pay benefits as they come due. For a plan that is funded, such investments would be the plan's investments; for a pay-as-you-go plan, the investments would be the employer's investments; for a plan that is partially funded, the investments would be a weighted average of expected plan and employer investments.[15]

A20. The GASB recognized that investment options for an employer's general investments may be more limited than those for a pension or employee benefit trust fund, and that therefore discount rates for unfunded plans generally may be lower. The GASB concluded that in either case the discount rate should reflect the expected yield on the assets expected to be used to finance the payment of benefits, and that pay-as-you-go employers generally could in fact expect to receive less help from asset earnings in financing the total cost of benefits.[16]

A21. Several of the respondents to the GASB ED leading to Statement 45 commented that they believe the proposal to base the selection of a discount rate on the expected long-term rate of return on the assets expected to be available to pay or provide OPEB when due would be problematic in practice. However, the GASB reaffirmed its original decision because its research indicated that actuaries would be able to develop an estimate of a blended discount rate based on the expected long-term rates of return on plan and employer investments.[17]

[12] SFFAS 5, par. 159.
[13] GASB 27, paragraph 10c, and GASB Statement 45, par. 13c.
[14] GASB 27, par. 91.
[15] GASB Statement 45, par. 120.
[16] GASB Statement 45, par. 121.
[17] GASB Statement 45, pars. 122-123.

A22. The IPSASB's recent exposure draft *Employee Benefits*,[18]would require defined benefit plans to determine the discount rate as follows:

> The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be a risk-free rate determined by reference to market yields at the reporting date on government bonds, or, where there is no deep market in government bonds, or where market yields at the reporting date on government bonds do not reflect a risk-free rate, by reference to market yields on high quality corporate bonds. The currency and term of the government bonds or corporate bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.[19]

A23. As previously stated, current FASAB standards provide two approaches for selecting discount rates. The first approach is the expected long-term return on plan assets. The second approach involves unfunded plans where an expected long-term return on plan assets is not available and a Treasury borrowing rate is required. This standard employs one approach for all instances not otherwise expressly provided in FASAB standards: discount rates for present value measurements of long-term liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the benefit payment for which the estimate is being made.

A24. The Board believes that discount rates for present value measurements of expense and liability amounts should be rates for marketable Treasury securities because they reflect the Government's borrowing cost with the public. Also, expected long-term rates reduce volatility, reflect the actual experience and expectations of the primary Federal plans, and are consistent with the assumptions used in the budget.

A25. This standard eliminates the plan's investment yield as an option for discount rates for present value measurements of expense and liability amounts. The discount rate assumption for long-term liabilities is used most significantly to calculate the present value of the obligation and the **annual cost increments** of net periodic cost, for example, the service cost component of pension expense. Both of those uses are conceptually independent of a plan's assets, if any. If two employers have made the same benefit promise, the FASAB believes the annual cost increments and the present value of the obligation should be the same even if one expected to earn an annual return of 6 percent on its plan assets and the other had an unfunded plan. However, the plan's portfolio of Treasury securities may be used for discount rates of present value measurements if the result is not materially different than the result using the approach in paragraphs 26-28.

A26. The Board notes that the Pension Protection Act of 2006[20] requires fund managers to focus on long-term interest rates instead of their particular asset holdings. The Act requires them to calculate pension liabilities based on current bond rates rather than the expected rate or return from an asset portfolio. Thus, high expected gains from stock

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[18] October 2006.
[19] IPSASB ED *Employee Benefits*, par. 90.
[20] PL No. 109-280

holdings will no longer be able to help diminish benefit liabilities since they will no longer be part of the calculation.

A27. The FASAB believes that the objective of discount rates is to reflect **the time value of money**. The time value of money should reflect the single amount that, if invested at the measurement date in risk-free investments with maturities like those of the future benefit payments being measured, would generate the necessary cash flows to pay the benefits when due. Marketable U.S. Treasury securities are deemed risk free because they pose neither uncertainty in timing nor risk of default to the holder. This single amount is the gross liability. It would equal, conceptually, the current market value of a portfolio of Treasury zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. In the absence of a portfolio of such zero coupon Treasury securities, however, the Federal preparer will need to incorporate in assumed discount rates the re-financing rates expected to be available on marketable Treasury securities in the future, which should be extrapolated from historical experience.

A28. With respect to Treasury rates the Board considered average historical rates as well as current market rates as of the reporting date. Some prefer current market rates, arguing that interest rates can move significantly from year to year and the use of interest rates from a prior year (or smoothing this year's rates with those from prior years) can therefore result in significant misstatements about the current value of future cash flows. They argue further that changing interest rate assumptions annually would result in more accurate but also more volatile estimates of liabilities and changes in net cost than the current actuarial practice in the Federal Government of revisiting interest rate assumptions every 3 to 5 years. They argue that the proposed display standard is the best way to deal with volatility, i.e., by reporting on a separate line changes in net cost due to changes in actuarial assumptions.

A29. The FASAB decided to require average historical rates rather than single-day or market rates on the reporting date. The Board believes that single-day rates would not reflect the long-term orientation of most Federal programs.

A30. This standard is not intended to change the Board's preference, expressed in SFFAS 5 and elsewhere, for expected long-term future trends rather than giving undue weight to recent past experience. With respect to assumptions in general, FASAB standards have emphasized expected long-term future trends.

A31. When discussing the discount rate, this standard does not use the term "effectively settle" that is well known from the usage in FAS 87. FAS 87 may have introduced some confusion by stating in paragraph 44 that the "discount rates shall reflect the rates at which the pension benefits could be effectively settled." Some have found the meaning of "effectively settled" to be unclear.

A32. The FASB changed this terminology in FAS 106. Consistent with FAS 87, the exposure draft on FAS 106 referred to "the interest rates inherent in the amount at which the postretirement benefit obligation could be effectively settled." Many respondents found that notion confusing because postretirement benefit obligations generally cannot be settled at the reporting date. Because respondents were confused about the meaning of "effectively settle," the FASB decided to not to use that phrase in FAS 106 in order to clarify that the objective of discount rates is to measure the time value of money.[21] FAS 157, *Fair Value Measurements*,[22] employs a similar approach.[23]

A33. Regarding the method of discounting cash flow in future years, the FASAB believes that discount rates used to measure the present value of the annual cost increments of expense should be selected that are applicable to the various benefit periods in question. The annual cost increments will be more representationally faithful if individual discount rates applicable to various benefit deferral periods are selected. However, a single average discount rate may be used for all projected future payments if the result is not materially different than the multiple-rate result, or for cases in which discount rates have limited influence on current liability estimates.

A34. This standard provides for the discount rates to be reviewed at each annual reporting date and changed if materially different from the existing rate. However, the Board prefers a stable discount rate that would result from applying historical averages, rather than current market rates. The Board believes that current market rates produce a degree of volatility that is not a faithful representation of the time value of money in long-term Federal programs. The Board also believes that implicit in the notion of stable rates is the fact that the discount rate normally would not change every year. The preparer would change the rate based on a significant change in the historical average Treasury rate, as determined by the preparer, which would reflect long-term expectations rather than the current market rate. Thus, this standard neither requires nor precludes annual changes in the discount rate. Current Office of Personnel Management practice is to maintain a constant discount rate for civilian pensions and other retirement benefits for five years. The Board does not anticipate that this standard would necessarily affect that practice because Treasury borrowing rates normally change very slowly.

A35. The discount rate standard in this statement does not apply to instances where the FASAB has required or permitted a discount rate to capture risk, i.e., to be other than the risk-free Treasury borrowing rate. However, the standard does apply to all instances where risk-free Treasury borrowing rates are appropriate.

Selecting Valuation Date

A36. The FASAB has addressed the issue of valuation dates for present valuations in various ways. The sections of SFFAS 5 dealing with pensions, ORB, and OPEB do not mention valuation dates, but the Board did address it Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* (August 1997). In Interpretation 3 the Board decided that pension and retirement health care liabilities should be measured for general purpose Federal financial reports as of the end of the reporting period, and that such measurement should be based on an actuarial valuation within a year of the end of the reporting period.

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[21] FAS 106, par. 188 and see FAS 106, par. 31.
[22] September 2006.
[23] FAS 157, par. B2.c.

A37. In Interpretation 3 the Board had been asked to endorse use of an actuarial valuation date as of the beginning of the fiscal year, which had been the practice in some of special purpose financial reports on pension plans prepared pursuant to statutory provisions. Some actuaries were concerned that differences between actuarial measurements used in different reports would cause problems and confusion. Some people who supported using a beginning-of-year valuation also were concerned about the potential for disagreements between auditors and preparers if projections or estimates were used instead of a full actuarial valuation. However, other people believed that liability measurements in financial statements prepared pursuant to SFFAS 5 should be as of the end of the reporting period, and that a measurement based on a projection or "roll forward" of a full actuarial valuation would be appropriate if it were not feasible to perform a full actuarial valuation as of year end.

A38. SFFAS 17, *Accounting for Social Insurance*, does address the valuation date, specifying that it should be as of any time within a year of the reporting date.

A39. Although it does not explicitly discuss the valuation date, SFFAS 5 implicitly calls for measurement at the reporting date for pensions, ORB, and OPEB liabilities, which are reported as of the balance sheet date.

A40. FASB's Statements 87 and 106 allowed preparers to use a valuation date for measuring pensions and other postretirement liabilities up to three months earlier than the reporting date. However, FAS 158 published under Phase I of FASB's pension project requires the measurement of plan assets and benefit obligations to be as of the date of the sponsoring employer's statement of financial position. The FASB concluded that this will more accurately reflect the economic status of defined benefit plans and further improve the understandability of the financial statements.[24]

A41. In Statement 27 and Statement 45, the GASB did not require the valuation date to be the employer's balance sheet date. Statement 27 requires the expense/expenditure amount to be based on the results of an actuarial valuation performed in accordance with the parameters as of a date not more than 24 months before the beginning of the employer's fiscal year. Statement 45 requires that the actuarial valuation date generally should be the same date each year (or other applicable interval). However, in both instances a new valuation would be required if, since the previous valuation, significant changes occurred that affect the results of the valuation, including significant changes in benefit provisions, the size or composition of the population covered by the plan, or other factors that impact long-term assumptions.

A42. The Board believes that the approach in Interpretation 3 is preferable. Long-term obligations such as those for pensions, ORB, and OPEB should be measured as of the end of the reporting period based on a full actuarial valuation within a year of the end of the reporting period. Thus, "full actuarial valuations," as that term is used by actuaries, can be performed as of an earlier date during the fiscal year than year end, including a beginning-of-year date, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise and cost of living adjustment. Such

[24] FAS 158, par. B16.

adjustments are sometimes referred to as a measurement based on a "projection" or "roll-forward."

A43. The statement also addresses an issue with respect to the meaning of “best estimate.” The statement provides that estimates should be reasonable under the circumstances (see paragraph 31). The notion of “best estimate” has been used in several FASAB standards, for example, in SFFAS 5, paragraph 65, SFFAS 7, *Accounting for Revenue and Other Financing Sources …*, paragraph 67.1, and in various instances in SFFAS 17. However, preparers and auditors have reported disagreements regarding the meaning of the word “best,” which is sometimes defined as “excelling all others.” Thus, the Board is proposing to replace the term “best estimate” in FASAB standards with “reasonable estimate.”

A44. Actuarial Standards of Practice (ASOP) provide guidance regarding the meaning of “best estimate.” ASOP 10, *Methods and Assumptions for Use in Life Insurance Financial Statements Prepared in Accordance with GAAP*, and ASOP 27, *Selection of Economic Assumptions for Measuring Pension Obligations.* ASOP 27 instruct actuaries to select a specific economic assumption from within his or her “best estimate range” with respect to that assumption, which it defines as “the narrowest range within which the actuary reasonably anticipates that the actual results … are more likely than not to fall”[25] [emphasis added]. ASOP 27 provides, generally, that

> “[b]ecause no one knows what the future holds with respect to economic and other contingencies, the best an actuary can do is to use professional judgment to estimate possible future economic outcomes based on past experience and future expectations, and to select assumptions based upon that application of professional judgment. Therefore, an actuary’s best-estimate assumption is generally represented by a *range* rather than one specific assumption. The actuary should determine the best-estimate range for each economic assumption, and select a specific point from within that range. In some instances, the actuary may present alternative results by selecting different points within the best-estimate range” [emphasis added].[26]

The FASAB concludes that ASOP 10 and 27 apply a standard of reasonableness regarding “best estimate,” and that that is an appropriate approach. Therefore, paragraph 31 of this proposed standard calls for the preparer’s estimate to reflect what is reasonable to assume under the circumstances, rather that the preparer’s “best estimate.”

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[25] ASOP 27, Section 2.1.
[26] ASOP 27, Section 3.1.

Appendix B: Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions

Component Entity:

Pro forma *Statement of Net Cost*

	2005 (millions)
ABC Program	
ABC expenses	$ 1,000
Less: exchange revenue	50
Net expense before gain/loss from changes in assumptions	950
(Gain)/loss on assumption changes:	
Discount rate assumption	600
Other assumptions	(100)
Net cost	$1,450

Governmentwide Entity:

Pro Forma *Statements of Net Cost*
for the Year Ended September 30, 2006

	Gross Cost	*Earned Revenue*	*Net Cost*
Department of Defense..........................	$ 623	$ 24	$ 599
Department of Health & Human Services....	679	51	628
* * *			
All Other entities...................................	146	92	54
Cost before gains/losses from changes in assumptions....................................	3,060	226	2,834
Less loss (plus gain) from changes in assumptions:			
DoD...	35	0	35
OPM...	1	0	1
VA...	31	0	31
Total cost	$ 3,128	0	$ 2,901

Appendix C: Pro Forma Note Disclosure of OPEB Liabilities and Expense

Post Employment Actuarial Liabilities
(in billions)

	Civilian	Military	Veterans	Balance Sheet Total
Beginning balance	1,496.3	1,563.0	924.8	4,062.1
Expense				
Service cost	41.5	33.4	XXX	
Interest on the liability balance	92.4	96.9	XXX	
Assumption changes	0.2	58.5	XXX	
Plan amendments (prior service cost)	-	25.8	XXX	
Actuarial (gain)/loss	1.9	4.6	XXX	
Other	(0.2)		XXX	
Total expense	135.8	219.2	XXX	
Less benefits paid	(67.6)	(52.9)	XXX	
Subtotal of pension and health	1,564.5	1,729.3	XXX	
Ending balance, other benefits	48.5	26.9	-	
Total post employment actuarial liabilities	1,613.0	1,756.2	1,122.6	4,491.8

Appendix D: Note 11 from FY 2006 Financial Report of the United States

Note 11. Federal Employee and Veteran Benefits Payable

The Government offers its employees life and health insurance, as well as retirement and other benefits. These benefits, which include actuarial and amounts due and payable to beneficiaries and health care carriers, apply to civilian and military employees.

The Federal Government administers more than 40 pension plans. OPM administers the largest civilian plan. DOD, meanwhile, administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard and the Foreign Service. The changes in the accrued post-retirement pension and health benefit liability and components of related expense for the years ended September 30, 2006, and 2005, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

	Civilian		Military		Total	
(In billions of dollars)	2006	2005	2006	2005	2006	2005
Pension and accrued benefits	1,349.0	1,273.8	967.1	895.4	2,316.1	2,169.2
Post-retirement health and accrued benefits	295.2	290.7	837.2	833.9	1,132.4	1,124.6
Veterans compensation and burial benefits	N/A	N/A	1,153.8	1,122.6	1,153.8	1,122.6
Life insurance and accrued benefits	34.2	32.9	-	-	34.2	32.9
FECA benefits	14.4	14.3	22.2	22.7	36.6	37.0
Liability for other benefits	1.5	1.3	4.4	4.2	5.9	5.5
Total Federal employee and veteran benefits payable	1,694.3	1,613.0	2,984.7	2,878.8	4,679.0	4,491.8

Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued pension liability as of September 30, 2005	1,273.8	895.4	2,169.2
Pension Expense:			
Normal costs	26.8	15.6	42.4
Plan amendment changes	-	0.1	0.1
Assumption changes	1.0	35.4	36.4
Interest on liability	78.0	55.0	133.0
Prior (and past) service cost	-	-	-
Actuarial (gains)/losses	29.7	6.1	35.8
Total pension expense	135.5	112.2	247.7
Less benefits paid	60.3	40.5	100.8
Actuarial accrued pension liability as of September 30, 2006	1,349.0	967.1	2,316.1

Significant Long-Term Economic Assumptions Used in Determining Pension Liability and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.00%	6.25%
Rate of inflation	3.50%	3.25%	3.00%	3.00%
Projected salary increases	4.25%	4.00%	3.75%	3.75%

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2005	290.7	833.9	1,124.6
Post-Retirement Health Benefits Expense:			
Normal costs	11.2	21.0	32.2
Interest on liability	17.1	52.9	70.0
Other actuarial (gains)/losses	(12.5)	(53.8)	(66.3)
Total post-retirement health benefits expense	15.8	20.1	35.9
Less claims paid	11.3	16.8	28.1
Actuarial accrued post-retirement health benefits liability, as of September 30, 2006	295.2	837.2	1,132.4

Significant Long-Term Economic Assumptions Used in Determining Post-Retirement Health Benefits and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.25%	6.25%
Rate of health care cost inflation	7.00%	7.00%	6.25%	6.25%

Separate boards of actuaries for OPM and DOD determine the actuarial assumptions used in calculating the pension liability and the post-retirement health benefit liability for the civilian and military personnel. Both boards use generally accepted actuarial methodologies. The board for OPM uses a fixed rate of inflation and projected salary increases over all years for both the pension and post-retirement health benefit liabilities. These rates are shown in the tables above. The board for DOD uses a range of rates for the inflation and the projected salary increases, with an ultimate rate for the long term. The board for DOD also uses different health care cost inflation rates for inpatient, outpatient, and prescription drugs. The long-term ultimate rate is shown in the tables above.

The long-term ultimate rate for fiscal year 2006 of 6.25 percent is shown in the tables above. For disclosure and comparison purposes, DOD's estimate of a single equivalent fixed rate of health care cost inflation for fiscal year 2006 is 7.20 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used.

Appendix E: Glossary

Actuarial Gains and Losses

A change in the value of a long-term liability (or the benefit plan's assets) resulting from experience different from that assumed or from a change in an actuarial assumption. Past experience is reflected in current costs through actuarial gains and losses.

Annual Cost Increment

The annual cost increment component of expense is the actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period. See **Service Cost** below for pensions, ORB, and OPEB.

Long-term Assumptions

Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events, for example, environmental clean-up payments, the entire series should be considered the event and, thus, the payment may commence within one year but would be required to extend at least five years. Otherwise, the asset or liability would be classified as short-term.

Marketable Treasury Securities

Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

Post-employment Benefits, Other (OPEB)

Forms of benefits provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or **Other Retirement Benefit** plans.

Prior Service Costs

The cost of retroactive benefits granted in a plan amendment.

Retirement Benefits, Other (ORB)

Forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, which are provided to retirees as the need for those benefits arises, such as certain health care benefits. Or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.

Risk-free Interest Rate

The rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows. See Time Value of Money below.

Service Cost

The service cost component of expense is the actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period. For pensions, ORB, and OPEB, it represents benefits attributed by the benefit plan formula to work in covered employment or other service rendered by the participant in the period. The service cost is a component of the annual expense and liability of the program and is not affected by the funded status of the plan.

Time Value of Money

The time value of money is represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows (risk-free interest rate). For present value computations denominated in nominal U.S. dollars, the yield curve for U.S. Treasury securities determines the appropriate risk-free interest rate. U.S. Treasury securities are deemed (default) risk free because they pose neither uncertainty in timing nor risk of default to the holder.

Appendix F: List of Abbreviations

ANPV	Actuarial net present value
CFS	Consolidated financial statements
CPI	Consumer Price Index
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Government Accounting Standards Board
OMB	Office of Management and Budget
OPEB	Other post-employment benefits
ORB	Other retirement benefits
PV	Preliminary Views
RSI	Required supplementary information
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards

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Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street NW, Suite 6814
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VIA Email Sent to: comesw@fasab.gov.

Dear Ms. Comes:

The Accounting Principles and Auditing Standards Committee "the Committee" of the Florida Institute of Certified Public Accountants "(FICPA)" has reviewed and discussed the proposed Statement of Federal Financial Accounting Standards entitled *Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*.

The Committee has the following comments regarding the specific questions contained in the exposure draft.

Display and Disclosure

Questions # 1-4: The Committee agrees with questions 1 through 4 because it believes the display of gains and losses from changes in assumptions as a separate item on the face of the financial statements is very informative and helps with the evaluation of the agency's actual performance. It also believes the disclosure of market rates for Treasury securities in the notes to the financial statements as a benchmark comparison with the discount rate used by the entity provides transparency for the users. Finally, it believes the division between short- and long-term assumptions is appropriate, as is the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement.

However, in response to question 5, the Committee takes exception to the use of average historical Treasury rates as the most appropriate discount rates for measuring long-term liabilities in the federal government. We believe that the current market rates of Treasury securities at the date of the financial statements would be the most appropriate discount rates to measure these liabilities because current market rates would better reflect the cost of issuing US Treasury securities to extinguish these long-term liabilities at the date of the financial statements. The use of current market rates would also provide more comparability and would be consistent with fair value accounting. But if the Committee were to use the average historical Treasury rates, then it would recommend applying a 5-year average, providing it is consistently followed from year to year, because the 5-year average better reflects current information about the current market rates of the US Treasury securities.

Selecting the Valuation Date

Question # 6: The Committee believes that the valuation date approach is appropriate.

Reasonable Estimate vs. Best Estimate

Question # 7: The Committee believes the approach regarding “reasonable estimate” rather than “best estimate” assumptions in paragraph 31 is appropriate.

Benefits and Costs

Question # 8: The Committee believes that overall this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. It also believes that in providing better disclosure on the face of the financial statements and comparability across agencies, the benefits outweigh the costs.

The Committee appreciates this opportunity to share its views and concerns and to comment on this Exposure Draft. Members of the Committee are available to discuss any questions you may have regarding this communication.

Very truly yours,

Yanick J. Michel, CPA, Chair
FICPA Accounting Principles and Auditing Standards Committee

Committee members coordinating this response:
J. Bryant Kirkland III, CPA
William D. Hughes, CPA
Richard Edsall

>>> "Sitrin, Joel B CIV DHRA" <Joel.Sitrin@osd.pentagon.mil> 11/30/2007 11:39 AM
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As requested. Hard copy will also be mailed.

Comments from DoD Office of the Actuary (OACT)

Requests for Comments

Display and Disclosure

Q1. This statement proposes to display gains and losses from changes in assumptions, including the discount rate assumptions, as a discrete item on the statement of net cost. See paragraphs **Error! Reference source not found.-Error! Reference source not found.** in the standard, paragraphs **Error! Reference source not found.**-A10 in the basis for conclusions, and the illustration in Appendix B, "Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions," for more information regarding display and disclosure.

1.1 Do you believe that the display will be informative?

OACT: Yes.

1.2 Do you believe the standard provides satisfactory guidance as to what should be displayed as gains or losses from changes in assumptions?

Please provide your rationale in as much detail as possible.

OACT: The 5-year concept appears reasonable, but there is some ambiguity in the wording. It should be noted that an assumption related to something that occurs within 5 years doesn't necessarily have to be *excluded* from what's shown as gains/losses due to assumption changes. For example, there may be a change in an assumption that specifically relates to something that occurs 2 years out in the current valuation (and 3 years out in the prior valuation); however, the effects may last longer—e.g., a COLA increase for a given year will affect pension amounts beyond that year. Even if an assumption about something that occurs within 5 years changes and there are no effects beyond that year, there should not be a prohibition against including it in gains/losses due to changes in assumptions.

While paragraph 21 includes the "but are not limited to" language, it is surprising the drafters of this ED did not include "size relative to the actuarial liability (AL)" as a factor. Language to that effect should be included in paragraph 21. The most important determinant of the significance of any actuarial gain/loss is its size relative to the AL, not the size compared to the same gain/loss the year before or the proportion of the change in net cost. (An exception to this in an unfunded liability valuation is experience gains/losses due to Fund yield assumptions, which should be evaluated relative to Fund size; but that case isn't relevant here.)

A similar lack of understanding is apparent in paragraph A7. Year-to-year volatility doesn't necessarily indicate anything of actuarial significance. For example, an assumption change gain/loss of 0.3% of the AL may represent a

large percentage change from an assumption change gain/loss of 0.1% of the AL the year before, but both are actuarially insignificant.

The ED fails to note the unavoidable grey areas that can result from benefit changes; specifically, how do you determine what is inherently part of the benefit change and what is an assumption change? Paragraph 21's allowance for judgment somewhat covers this; however, it should be noted that this is an example of something requiring judgment.

Related to this, new statutory benefit provisions—creating programs for which no prior experience data exists—obviously lead to the potential for assumption-change gains/losses. The effects can be indirect, e.g., changes to retiree health provisions for over-65 beneficiaries can have impacts on participation by under-65's, which may be a separate assumption. These necessary assumption-change gains/losses are attempts to predict future unknown experience. Assumptions are at best no better than guesses, with varying degrees of experience to consider depending on the available history of credible data. As experience emerges, refining the assumptions may be possible, but in each case assumption-change gains/losses will occur. Note also that there are occasions where historical experience alone is not considered the best predictor of future experience. In a given valuation, assumption change gains/losses are attempts to better model future experience and therefore to reduce future experience gains/losses; experience gains/losses pertain to the effect of the valuation year's experience. Hence the relative sizes of the two different categories of gain/loss in a given valuation does not indicate anything of significance. Paragraph A1 demonstrates a lack of understanding of this fact.

Q2. The statement also proposes that the components of the expense associated with long-term liabilities be disclosed in notes to the financial statements. See paragraphs **Error! Reference source not found.** and **Error! Reference source not found.** in the standard, paragraph **Error! Reference source not found.** in the basis for conclusions, and the illustration in Appendix C, "Pro Forma Note Disclosure of Liabilities and Expense," for more information regarding display and disclosure.

Do you believe that disclosure of the components of expense is informative? Please provide your rationale in as much detail as possible.

OACT: Yes, although we already provide this information. It appears you are eliminating the requirement (paragraph 88 in SFFAS 5) to show the gain/loss due to changes in the medical trend assumptions as a separate line item (it now can be included in the gains/losses due to changes in assumptions). We have no objection to that. If the intent is to eliminate that requirement, paragraph 88 of SFFAS 5 should be amended, but the ED does not show that in the "Effect on Prior Standards" section.

<u>Selecting the Discount Rate Assumption</u>

Q3. This statement proposes that the preparer provide the 10-, 20- and 30-year market rate for Treasury securities in the notes to the financial statements as a benchmark comparison with the discount rate used by the entity. See paragraph **Error! Reference source not found.** for the note disclosure standard and paragraph **Error! Reference source not found.** in the basis for conclusions for the rationale for the disclosure of market rates.

Do you believe that disclosure of market rates as described above is informative? Please provide your rationale in as much detail as possible.

OACT: (You mean paragraph 24.) This would not be informative and in fact would be confusing. If current market rates are not the basis for calculating the AL, there is no reason to disclose them as a "benchmark comparison." The notes should include the basis for selecting the discount rate. In the case of DoD retirement and retiree health, the basis for the discount rate assumption (and other key assumptions) is the relevant statutorily created Board of Actuaries (Chapters 74 and 56, respectively, of Title 10, USC) that oversees the Fund. In other words, stating that the discount rate assumption is 6% because that's what the Board decided is appropriate and sufficient. Using different assumptions in financial statement valuations than those used in valuations to support Board requirements would lead to unnecessary confusion and is not warranted. More on this later in our comments.

Q4. The statement addresses long-term assumptions that have a material effect on the reporting, for example, those used for measuring expense and liabilities associated with pensions, other retirement benefits, and post-employment benefits. The statement excludes short-term assumptions of which it provides specific examples (see paragraph **Error! Reference source not found.**), and defines "long-term assumptions" as those involving projections of 5 years or more (see paragraph **Error! Reference source not found.**) and, accordingly, short-term assumptions as those involving projections of fewer than 5 years.

4.1 Do you believe that the 5-year division between short- and long-term assumptions is appropriate?

OACT: See comments above in response to 1.2.

4.2 Do you believe the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement is appropriate?

OACT: It seems appropriate although again there is some ambiguity. Although not in our purview, it seems that items like accounts receivable and accounts payable should not require a separate line item for gains/losses (or "changes attributable to", as the terms "gain" and "loss" are typically only used for actuarial liabilities) due to assumption changes. An item that is in our purview—Incurred-But-Not-Reported (IBNR) liabilities—definitely should not require a separate line item for changes attributable to assumption changes. It isn't warranted and would be contrary to standard practice. The 5-year concept for the most part seems about right, although it shouldn't be considered a hard-and-fast rule. For example, IBNR might theoretically

involve miniscule cash flows that could extend longer than 5 years, although the amounts are completely immaterial. Paragraph 21 is probably sufficient to cover this.

4.3 Are "short-term assumptions" clearly delineated?

4.4 Should other short-term assumptions be listed as examples?

OACT: Should include assumptions related to IBNR.

Please provide your rationale in as much detail as possible.

Q5. This statement proposes a standard for selecting the discount rates for present value measurements of expense and liability amounts. The standard provides that the discount rate should be the interest rate(s) on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rate(s) should reflect average historical rates on marketable Treasury securities rather the current market rate(s). See paragraphs **Error! Reference source not found.**-28 in the standard and paragraphs **Error! Reference source not found.-Error! Reference source not found.** and especially A28 in the basis for conclusions.

5.1 Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?

OACT: The ED is correct in noting that the long-term focus of federal programs makes use of current market rates as the basis for the discount rate inappropriate. However, there are several problems with the ED's proposals related to discount rates.

The requirement (paragraphs 27 and A33) to use year-specific discount rates—essentially a select-and-ultimate (s&u) approach—is fundamentally inconsistent with the new-entrant-cohort version of the Aggregate Entry Age Normal (AEAN) cost method, the method required by SFFAS 5. This new-entrant-cohort version is an accepted, appropriate version of AEAN that is described by both Tino and Sypher (Society of Actuaries Study Note 360-28-95) and Daskais (Study Note 360-21-91) . Requiring the s&u approach would result in internally inconsistent standards.

A significant portion of the problem is the fact that under this method, the normal cost percentage (of pay), or the NCP (in the case of pensions), should not change in consecutive valuations if assumptions don't change. However, with s&u discount rates the NCP does change if assumptions don't change. For example, if projection-year-specific discount rate assumptions in one valuation are 10%, 9%, 8%, 7%, 6%, 6%, 6%, etc, then not changing the assumptions for the following valuation would require 9%, 8%, 7%, 6%, 6%, 6%, 6%, etc, which would result in a change in the NCP. The problem is not alleviated by attempting to characterize the varying discount rates on a duration-specific—as opposed to projection-year specific—basis, as the ED does in paragraph 27. While keeping duration specific discount rates constant

may leave the NCP unchanged, it will lead to an overall gain/loss, and further, duration-specific characterizations can be mathematically converted to a projection-year specific basis. Thus unchanged on a duration-specific basis does not equate to unchanged on a projection-year specific basis. This ambiguity creates confusion as to what constitutes a change in assumptions.

The problem is not alleviated by paragraph 27's allowance for a single rate if the "result" is not materially different. This still would require doing the calculation under the flawed s&u approach as a comparison to show the "result" is not materially different. Also, which "result" must not be materially different? Different single rates would be required for the overall liability vs. the various components of expense to not materially differ. The standard should not require s&u, nor a comparison to it, even if the FASAB Board wants to allow it. Again, this would result in an internally inconsistent standard. Note that the ASOPs do not require s&u.

Paragraph A24 is correct in arguing for expected long-term rates; however, the perspective of the government's borrowing cost with the public isn't necessarily relevant from the point of view of the employer entity (e.g., the DoD in the case of the Military Retirement System) in the case of a "funded" plan. From DoD's perspective, the plan is funded. Therefore the investment yield perspective for the discount rate has relevance. From the employers' perspective, the statement in A25 about the equivalence of two plans with the same benefit provisions (one funded and one not) isn't necessarily correct. From the overall federal government perspective, it isn't clear what constitutes the best basis for the discount rate assumption.

From the overall government, or US Treasury perspective, Paragraph A24's statement that the rationale for using marketable Treasury securities for the discount rate is that they reflect the government's borrowing cost with the public is questionable. A private company would not value a given future obligation at its own borrowing cost. However, in the sense that Treasury securities represent risk-free investments, as described in A27, arguments can be made for their use as the discount rate basis. In the case of US Military pensions and retiree health benefits, using Board assumptions for the financial statement valuations makes the most sense. Congress has created "funding" in a trust fund comprised entirely of investments that mirror marketable US Treasury securities, and further has created independent expert Boards for setting the assumptions used in the valuations of these plans. The Board assumption basis is reasonable from the employer perspective (i.e., the investment yield perspective) and is also reasonable in terms of the perspective advocated in A27 because of the nature of the trust funds. The Board's assumption for the discount rate relates to a long-term assumption of yields on risk-free US Treasuries, given the investments to which the trust funds are restricted. Arguments that the discount rate shouldn't be impacted by the particular portfolio of securities in the trust funds (which were purchased at various prior times) at a given time, aren't valid in the context of an alternative involving a vague, undefined "historical" average. Board assumptions as to long-term yield on the trust funds is as good a basis as any to determine the discount rate, and is in fact more credible given the independence and the credentials of the Board members.

Use of Board assumptions also guarantees internal consistency among the assumptions, as the Board's assumptions and methods are required to be "in accordance with generally accepted actuarial principles and practices." Use of Board assumptions is consistent with the concept advocated in A34 that the discount rate shouldn't necessarily change every year.

An important point is that the focus be long-term, not based on current, snapshot market rates. The ED addresses this to some extent in acknowledging the need for consideration of expected re-financing rates.

Paragraph 28's statement about the need for exercising judgment in selecting the discount rate is appropriate. Implications that discount rates—no matter how they're selected—can be known with a high degree of precision, given the time-frame underlying the actuarial liability calculations, are misleading and deceptive.

5.2 How would you interpret the word "historical" in the phrase "average historical Treasury rates," for example, a 1-year average? 5-year average? 20-year average?

OACT: As previously stated, it's unclear. This isn't to suggest a precise definition should be used to determine the discount rate. Rather, the lack of a precise definition is consistent with Paragraph 28's statement about the need for judgment, and therefore also consistent with the idea of using the discount rate assumption set by Congressionally-established expert Boards for trust funds restricted to investing in securities that mirror marketable US Treasury securities.

5.3 The proposed standard incorporates prior FASAB guidance regarding selecting economic assumptions. It invokes Actuarial Standards of Practice and does not affect the explicit SFFAS 5 requirement for consistency among assumptions. See ED paragraphs 33, which contains revisions to relevant SFFAS 5 paragraphs. Some observers advocate expanding the scope of the standard to provide for selecting all economic assumptions because they are concerned about consistency between the discount rate and other economic assumptions employed. Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph 33 of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions?

Please provide your rationale in as much detail as possible.

OACT: The cross-reference to the ASOPs makes it sufficient.

<u>Selecting the Valuation Date</u>

Q6. This statement proposes a standard for selecting the valuation date for present valuations for long-term liabilities. See paragraphs **Error! Reference source not**

found.-Error! Reference source not found. in the standard and paragraphs **Error! Reference source not found.**-A44 in the basis for conclusions.

Do you believe the valuation date approach is appropriate? Please provide your rationale in as much detail as possible.

OACT: The valuation date approach is appropriate. With respect to the measurement, reporting, and valuation dates, the ED is not changing current practice as per Interpretation 3. This approach is already being used.

<u>Reasonable Estimate vs. Best Estimate</u>

Q7. This statement involves estimates that reflect the preparer's judgment about the outcome of events based on past experience and expectations about the future. Estimates are to reflect what is reasonable to assume under the circumstances rather than the preparer's "best estimate" or other phraseology. The preparer may use his or her own assumptions about future cash flows. However, the entity should explain why it is inappropriate to use assumptions generally used in the federal government, as evidenced by independent sources, if the assumption the entity used is different. See paragraph **Error! Reference source not found.** in the standard and paragraphs **Error! Reference source not found.**-A44 in the basis for conclusions.

Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate? Please provide your rationale in as much detail as possible.

OACT: You mean paragraph 32. The approach regarding "reasonable estimate" rather than "best estimate" is appropriate and consistent with the ASOPs, particularly the section of ASOP 27 referenced in paragraph A44. The FASAB's conclusion articulated in A44 is appropriate and correct.

However, the end of paragraph 32, beginning with, "…the entity should review assumptions used generally in the Federal Government as evidenced by independent sources…" is inappropriate unless the DoD Boards are considered "independent" sources. There is no overarching assumption-setting body for the Federal Government. Which assumptions are supposed to be used as the comparison? Congress made the DoD Boards independent, and the law (Chapters 74 and 56 of Title 10, USC) does not require that the assumptions used for valuing the Military Retirement System or the Retiree Health program conform to any particular federal government assumptions. The only requirement is that the assumptions be approved by the Boards and conform to "generally accepted actuarial principles and practices." Of significance is the statement in section 1053 of the 1983 House Armed Services Committee Report 98-107 (which accompanied the legislation creating the Military Retirement Fund), "Care must be exercised to minimize the ability to manipulate the interest rate. The committee recommends that an independent Board of Actuaries be established and that they, alone, be charged with the responsibility for determining the interest rate and other actuarial assumptions in accordance with generally accepted actuarial principles and practices."

Benefits and Costs

Q8. The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal.

Please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal in whole or in part. Please provide your rationale as much detail as possible.

OACT: As previously stated, the standard as proposed creates an internal inconsistency with the year-specific discount rate proposal (paragraphs 27 and A33). Again, the allowance for use of a single rate if the "result" is not materially different does not alleviate the problem.

We have also explained why it is important that Board assumptions be used for the financial statement valuations. Also, we have concerns about requiring a disclosure of current market rates on US Treasuries and a requirement to justify assumptions not matching some sort of undefined "independent" source for assumptions "used generally in the Federal Government" unless the DoD Boards are clearly considered legitimate "independent sources."

Joel Sitrin, DoD Chief Actuary
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DEPARTMENT OF VETERANS AFFAIRS
DEPUTY ASSISTANT SECRETARY FOR FINANCE
WASHINGTON DC 20420

DEC 6 2007

Ms. Wendy M. Combs, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Combs:

The Department of Veterans Affairs (VA) has reviewed the exposure draft, "Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates" and offers responses to the following "Questions for Respondents."

1.2 Do you believe the standard provides satisfactory guidance as to what should be displayed as gains and losses from changes in assumptions?

It would be useful to be somewhat clearer in the *Glossary* regarding what is meant by "long-term assumptions." Usually such assumptions would be demographic or economic in nature, while the definition refers to a series of events which may not be a component of long-term assumptions. Nevertheless, we believe that this could be interpreted to include all demographic and economic assumptions relating to all future benefit payments of a program such as the VA compensation program. It would not make sense to make an arbitrary cutoff for economic and demographic assumptions for a given period.

5.1 Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?

Yes. Appropriately chosen historical Treasury rates can emphasize expected long-range future trends. "Single day" rates include short-term volatility which can distort the value of long-term liabilities. Intuitively, the liabilities develop and run-off over long periods of time so it is reasonable the discount rate should reflect a longer timeframe.

5.2 How would you interpret the word "historical" in the phrase "average historical Treasury rates," for example, a 1-year average? 5-year average? 20-year average?

VA would prefer to see more guidance regarding the time period used for averaging. Also, the averaging method could be clarified: weighted versus un-weighted and arithmetic average versus geometric average. It would be beneficial to have the discussion of these details prior to audit time.

Page 2.

Ms. Wendy M. Combs

5.3 The proposed standard incorporates prior FASAB guidance regarding selecting economic assumptions. It invokes Actuarial Standards of Practice and does not affect the explicit SFFAS 5 requirement for consistency among assumptions. See ED paragraphs 33, which contains revisions to relevant SFFAS 5 paragraphs. Some observers advocate expanding the scope of the standard to provide for selecting all economic assumptions because they are concerned about consistency between the discount rate and other economic assumptions employed. Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph 33 of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions?

Yes. The proposed standard states the need for consistency between assumptions, and particularly between economic assumptions, in several places.

7. Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate?

The approach regarding "reasonable estimate" as described in paragraph 32 is appropriate. However, note that at least one of the example assumptions given, the cost of living adjustment, is at least to some extent related to interest rates. We are concerned that the guidance provided in this paragraph, which permits the use of the entity's own assumptions as long as they can be justified if they deviate from independent sources, may prove inconsistent with the historical interest rates used in setting discount rates. A discussion of this possible inconsistency might be included as guidance.

Other comments:

- In paragraph 24, we believe that it would be more appropriate to refer to "rate(s)" rather than "rate."
- In paragraph 27, "cash flows" should be used in place of "payments" and "effect of using" should be inserted before "multiple-rate" in the last line.
- Beginning with Paragraph 29, the phrase "expected re-financing rates extrapolated" is used throughout the remainder of the Exposure Draft. We believe that this phrase should be clarified with further guidance or explanation.

Page 3.

Ms. Wendy M. Combs

- We suggest that the definition of "Prior Service Costs" be refined. First, the current definition includes "in a plan amendment" when for many programs, such as the VA compensation program, there is no "plan." We suggest either deleting this phrase or adding retroactive benefits provided through new legislation or regulation.

If you have any questions, please have your staff call Pete Mulhern, Cost and Debt Management Service, at (202) 461-6487.

Sincerely,

Edward J. Murray

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE ASSISTANT SECRETARY

11 January 2008

MEMORANDUM FOR MS. WENDY M. COMES
Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street NW, Suite 6814
Washington, DC 20548

FROM: SAF/FMC
1130 Air Force Pentagon
Washington DC 20330-1130

SUBJECT: Exposure Draft, *Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates, August 3, 2007*

As the Chairman of the Air Force Nonappropriated Fund Investment Subcommittee of the Air Force Morale, Welfare, and Recreation Board, I welcome the opportunity to provide comments on the subject Exposure Draft (ED). As noted in the ED on page 1, "...The devised standard will result in more transparent and useful information prepared in a more consistent manner that will improve the ability of readers to assess operating performance and stewardship..."

My first comment supports the inclusion of data which shows impact of changes in assumptions, as reflected in Appendix B (page 28) of the ED. I recommend adding to the example in Appendix B the specifics of those changes. These are not currently in the Appendix B example, it includes only the results of those changes. If actuarial assumptions change, the discount rate changes, etc., those changes should be cited. As an example, the statement "Adoption of New Mortality Tables increasing life expectancy from age 86 to age 88" would help to provide better transparency when included with the financial data.

Second, I believe the example in Appendix D (page 31) should also include the assumed rate of return on the assets, not just the rate of return on U.S. Treasury Securities. Since a pension plan would often include a certain percentage of its portfolio in equities, corporate bonds, etc., the rate of return reflecting that asset allocation should be provided. Otherwise, there may be a disconnect from what the plan is actually earning on its assets if only the interest rate on U.S. Treasury Securities is included. This would mean two estimates of pension liability and the related expense: one based on U.S. Treasury Securities and one based on the assumed rate of return on the plan's actual assets. In addition, the specific maturity should be included for the U.S. Treasury Securities.

Third, and consistent with the second comment, the allocation of the fund's assets, by general category, should be included in Appendix D. For example, Equities 55%, Fixed Income 45%. This would provide added transparency based on the allocation used for the assumed rate of return.

The following table reflects our proposed changes to Appendix D (page 31) as noted by the blue italics.

Significant Long-Term Economic Assumptions Used in Determining Pension Liability and the Related Expense

	Civilian		Military	
(in percentages)	2006	2005	2006	2005
Rate of Interest *U.S. Treasury Securities (1)*	6.25%	6.25%	6.00%	6.25%
Rate of Return on Assets (2)	*8.00%*	*8.00%*	*8.00%*	*8.00%*
Rate of Inflation	3.50%	3.25%	3.00%	3.00%
Projected Salary Increase	4.25%	4.00%	3.75%	3.75%

Notes:
(1) Weighted Average Maturity 9.3 years as of December 31, XXXX
(2) Asset Allocation: Equities 55%, Fixed Income 45% as of December 31, XXXX

Finally, a comparison of a fund's financial position, using both the discount rate on U.S. Treasury Securities and the discount rate on the actual assets of the fund would clearly indicate the impact of these different discount rates. As the ED is currently structured, only the U.S. Treasury rate would be used. This does not provide an adequate view of the fund's overall financial position and its sensitivity to different discount rates.

I think these recommendations will help to achieve better transparency and an improved ability to "…assess operating performance and stewardship…"

Please direct any questions to Mr. Wally Erck, SAF/FMCEB, (703) 695-4730 or at wally.erck@pentagon.af.mil.

RICHARD K. HARTLEY
Deputy Assistant Secretary
(Cost and Economics)

AGA

Advancing Government Accountability

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January 15, 2008

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Payne:

The Association of Government Accountants (AGA) Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the recent exposure draft (ED) issued by the Federal Accounting Standards Advisory Board (FASAB or the Board) of a proposed Statement of Federal Financial Accounting Standards. Its title is ***Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates****.* The FMSB, comprising 22 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

We agree that displaying gains and losses from changes in assumptions as discrete line items on the statement of net cost will enhance the usefulness of the information provided on the statement of net cost. It will increase the readability of the statement and make it easier for users to assess operating performance and stewardship. We also approve of the issuance of guidance regarding rates to be used for discount rates for present value measurements of expense and liability amounts since it will reduce the current uncertainty in practice and create more consistency and comparability in reporting.

The FMSB has the following specific comments answering the questions in the ***Questions for Respondents*** section.

Display and Disclosure

Q1. *This statement proposes to display gains and losses from changes in assumptions, including the discount rate assumptions, as a discrete item on the statement of net cost. See paragraphs 19-26 in the standard, paragraphs A1-A10 in the basis for conclusions, and the illustration in Appendix B, "Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions," for more information regarding display and disclosure.*

1.1 *Do you believe that the display will be informative?*

Yes. The largest amounts on the statement of net cost for the Financial Report of the United States Government (FR) and for the certain component

CGFM

entities can result from gains and losses from changes in assumption. Bases for conclusion A6 and A7 appropriately address this.

***1.2** Do you believe the standard provides satisfactory guidance as to what should be displayed as gains or losses from changes in assumptions?*

Yes. "Statement of Federal Financial Accounting Standards (SFFAS) 5 provides standards for several types of liabilities, some of which require present value valuations." "…the Board is extending the Interpretation 3 approach to expense and liability measurement for long-term liabilities, including OPEB." "…assumptions are considered **long-term assumptions** if the underlying event about which the assumption is made will not occur for five years or more." … "Otherwise, assumptions would be considered short-term." "The statement does not apply to certain long-term liabilities or allowances on losses where the FASAB has specifically provided standards."

Paragraphs 19 and 20 define what should be displayed as gains or losses from changes in assumptions.

***Q2.** The statement also proposes that the components of the expense associated with long-term liabilities be disclosed in notes to the financial statements. See paragraphs 22 and 26 in the standard, paragraph A9 in the basis for conclusions, and the illustration in Appendix C, "Pro Forma Note Disclosure of Liabilities and Expense," for more information regarding display and disclosure.*

Do you believe that disclosure of the components of expense is informative? Please provide your rationale in as much detail as possible.

Overall, we believe the disclosure of the components of the expense is informative.

For Component Entities, paragraphs 19 and 23 seem clear, and seem to provide informative disclosure. Paragraph 24 could be interesting, but these long-term rates should not fluctuate dramatically from year to year. However, if any single-year deviation from the average historical rate was disproportionately large, it could signal a significant danger to the sustainability of federal government fiscal and economic policies in force.

For Governmentwide Entity, Paragraph 25 is not parallel with Paragraph 19. It does not specify "changes in **<u>long-term</u>** assumptions", merely "changes in assumptions". Paragraph 14 states that "This statement applies to liabilities that employ long-term assumptions, unless FASAB standards specifically provide otherwise." Basis for conclusion A8 addresses this issue…. So we suggest that the Board consider clarifying if Paragraph 25 and Paragraph 22 are intended to be different in their use of the term, "changes in assumptions."

We believe the illustrations in Appendix B and C are useful and informative.

<u>Selecting the Discount Rate Assumption</u>

***Q3.** This statement proposes that the preparer provide the 10-, 20- and 30-year market rate for Treasury securities in the notes to the financial statements as a benchmark comparison with the discount rate used by the entity. See paragraph 24 for* *the note disclosure standard and paragraph A10 in the basis for conclusions for the rationale for the disclosure of market rates.*

Do you believe that disclosure of market rates as described above is informative? Please provide your rationale in as much detail as possible.

See answer to Q2 above

Q4. *The statement addresses long-term assumptions that have a material effect on the reporting, for example, those used for measuring expense and liabilities associated with pensions, other retirement benefits, and post-employment benefits. The statement excludes short-term assumptions of which it provides specific examples (see paragraph 20.A), and defines "long-term assumptions" as those involving projections of 5 years or more (see paragraph 15) and, accordingly, short-term assumptions as those involving projections of fewer than 5 years.*

4.1 Do you believe that the 5-year division between short- and long-term assumptions is appropriate?

Yes, provided the issue stated in my response to Q2 above is resolved.

4.2 Do you believe the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement is appropriate?

Yes

4.3 Are "short-term assumptions" clearly delineated?

Yes

4.4 Should other short-term assumptions be listed as examples? Please provide your rationale in as much detail as possible.

We cannot think of any

Q.5 *This statement proposes a standard for selecting the discount rates for present value measurements of expense and liability amounts. The standard provides that the discount rate should be the interest rate(s) on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rate(s) should reflect average historical rates on marketable Treasury securities rather than the current market rate(s).*

5.1 *Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?*

Yes, we believe the selected rates are appropriate for measuring long-term liabilities.

***5.2** How would you interpret the word "historical" in the phrase "average historical Treasury rates," for example, a 1-year average? 5-year average? 20-year average?*

We think a 5-year average of Treasury rates is the best time period for calculating a discount rate for measuring long term liabilities. There are several reasons for this, the first being that it is a very common practice to use sixty observation points over a 5-year period (monthly points) to construct a discount rate. Secondly, the use of a 5-year time period smoothes out short-term volatilities arising from various individual events that impact the securities markets and temporarily move interest rates. Thirdly, the 5-year time period is sensitive enough to longer-term movements in interest rates to be useful in estimating a realistic trend in interest rates; it embodies longer-term views of what is happening in various interest rates over time.

***5.3** The proposed standard incorporates prior FASAB guidance regarding selecting economic assumptions. It invokes Actuarial Standards of Practice and does not affect the explicit SFFAS 5 requirement for consistency among assumptions. See ED paragraphs 33, which contains revisions to relevant SFFAS 5 paragraphs. Some observers advocate expanding the scope of the standard to provide for selecting all economic assumptions because they are concerned about consistency between the discount rate and other economic assumptions employed.*

Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph 33 of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions? Please provide your rationale in as much detail as possible.

We agree that the guidance in revised SFFAS 5 paragraphs is sufficiently specific.

<u>Selecting the Valuation Date</u>

***Q6.** This statement proposes a standard for selecting the valuation date for present valuations for long-term liabilities. See paragraphs 30-32 in the standard and paragraphs A36-A44 in the basis for conclusions.*

Do you believe the valuation date approach is appropriate? Please provide your rationale in as much detail as possible.

We do believe that the valuation date approach is appropriate. It reflects good practice and a good cost/benefit balance in forming assumptions and estimating impacts from events. We agree with A42 discussion. "Full actuarial valuations" should not be subject to major changes within a relevant time frame, except for adjustment for any subsequent material events.

<u>Reasonable Estimate vs. Best Estimate</u>

***Q7.** This statement involves estimates that reflect the preparer's judgment about the outcome of events based on past experience and expectations about the future. Estimates are to reflect what is reasonable to assume under the circumstances rather than the preparer's "best estimate" or other phraseology. The preparer may use his or her own* *assumptions about future cash flows. However, the entity should explain why it is inappropriate to use assumptions generally used in the federal government, as evidenced by independent sources, if the assumption the entity used is different. See paragraph 32 in the standard and paragraphs A43- A44 in the basis for conclusions.*

Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate? Please provide your rationale in as much detail as possible.

This is a particularly difficult issue, and the FASAB's care in approaching it is commendable. The term "best estimate" is problematic, but the term "reasonable estimate" is problematic as well, without some indication of what could be considered reasonable. However, including a specific process for estimating the future outcomes of events and future expectations in a standard may cause unwarranted inflexibility for the preparer in exercising their judgment as to what best represents the underlying economic reality as presented in their financial statements. It might also cause an auditor of the financial statements to qualify a specific representation, based on the preparer's choice of estimating methods, even though all parties agree that the future is unknown and no estimate can give a perfect representation of the future. We agree with the analysis provided in A44 and wonder whether reference to ASOPs 10 and 27, or at least ASOPs in general, might be somehow referenced in the standard. But perhaps providing the basis for conclusions discussion, as it stands in the ED, is sufficient.

<u>Benefits and Costs</u>

Q8. *The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal.*

Please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal in whole or in part. Please provide your rationale as much detail as possible.

There should be substantial benefit to users in better disclosing the impact on the financial statements arising from changes in assumptions, and in further standardizing across the federal government the selection/calculation of discount rates for valuing long-term liabilities. It seems to me that the FASAB has reasonably balanced the provision of useful information with the costs of providing it, particularly in addressing valuation dates.

We appreciate the opportunity to comment on this exposure draft and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions on the letter, please contact Anna D. Gowans Miller, CPA, AGA's Director of Research and staff liaison for the FMSB, and facilitator for this project, at amiller@agacgfm.org or (703) 562-0087.

Sincerely,

Robert L Childree

Robert L. Childree, Chair,
AGA Financial Management Standards Board

cc: Richard L. Fair, CPA
AGA National President

Association of Government Accountants
Financial Management Standards Board

July 2007 – June 2008

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Anna D. Gowans Miller, Technical Manager, AGA, Staff Liaison

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

TAKE PRIDE IN AMERICA

JAN 15 2008

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW
Mailstop 6K17V
Washington, DC 20548

RE: FASAB Exposure Draft, *Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, dated 3 August 2007

Thank you for the opportunity to review and comment on the FASAB Exposure Draft (ED), *Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, dated August 3, 2007.

As discussed in more detail within Enclosure 1, the Department believes this ED attempts to broadly address present value calculations, assumptions, and discount rates related to limited and certain federal components without considering the value of dealing specifically with items that may need specificity. A detailed reading of this ED and its Basis for Conclusions in Appendix A make it apparent that its intent focused on employee benefit obligations and not environmental and contingent liabilities. The Department would like to see these elements removed from this draft and, if the Board believes their accounting to be lacking, they should be addressed separately and distinctly. The complexities and elements within these two liabilities already require extraordinary effort and drain resources within the compressed timeframes of current reporting. In addition, the Department has concerns that the broad and non-specific elements captured within the scope will prove extremely difficult and costly to implement without adding clear value to the Statement of Net Cost. Accordingly, the Department does not recommend implementation of this ED and its requirements as currently written.

Again, thank you for the opportunity to respond to these questions. If you need any additional information, please contact me or Ernest Goebel at (202) 208-4701.

Sincerely,

Daniel L. Fletcher
Director, Office of Financial Management

Enclosure

Enclosure 1

The Department of the Interior Response to FASAB Exposure Draft: Reporting Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates, dated August 3, 2007

The Department's responses to the Questions to Respondents are as follows:

Display and Disclosure

Question 1: *This statement proposes to display gains and losses from changes in assumptions, including the discount rate assumptions, as a discrete item on the statement of net cost. See paragraphs 19-26 in the standard, paragraphs A1-A10 in the basis for conclusions, and the illustration in Appendix B, "Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions", for more information regarding display and disclosure.*

1.1 Do you believe that the display will be informative?

Department Response to Question 1.1: The Department does not believe the display will be informative for most departments and most bureaus/offices. For example, it is our understanding that the Department of Labor (DOL) and Office of Personnel Management (OPM) calculate pension and other post-employment benefits (OPEB) costs; not the departments or bureaus/offices. Then DOL and OPM allocate these costs between the departments, who further allocate the cost between their bureaus/offices. Any effort to separate the gains or losses based upon cost at the department and subsequently at the bureau/office level would be meaningless. We do not believe the guidance in this ED should apply to any cost data, which is calculated by one entity, and subsequently allocated between several other entities, based upon unidentified percentages or other factors.

1.2 Do you believe the standard provides satisfactory guidance as to what should be displayed as gains or losses from changes in assumptions?

Please provide your rationale in as much detail as possible.

Department Response to Question 1.2: No, the Department bases this response upon our belief that this ED applies to a very limited Federal audience. We suggest that the use of high-level generalities diminishes the usefulness of the guidance. We suggest the FASAB direct their guidance to those entities that have displayed material gains or losses as the result of changes in assumptions and that they determine who is responsible for the cost calculations before attempting to provide blanket guidance. The standard does not provide specific examples of assumption changes that a reader can consider and attempt to apply it to their situations.

Question 2: *The statement also proposes that the components of the expense associated with long-term liabilities be disclosed in notes to the financial statements. See paragraphs 22 and 26 in the standard, paragraph A.9. in the basis for conclusions,* *and the illustration in Appendix C, "Pro Forma Note Disclosure of Liabilities and Expense", for more information regarding display and disclosure.*

Do you believe that disclosure of the components of expense is informative? Please provide your rationale in as much detail as possible.

Department Response to Question 2: No, the Department does not believe that disclosure of long-term liabilities by components would provide more meaningful and useful information. The limited specifics provided in this guidance are so vague that it is hard to determine whether regular long-term construction contracts or procurements would fall under this guidance. We question whether Federal entities could even implement these requirements.

Most contracting and procurement transactions are charged to one or two accounting codes and one standard general ledger (SGL) account by field and procurement personnel based upon the work being done. It is an unrealistic and an unnecessary burden to expect employees to try to break every long-term contract into the proposed components since it would mean they would have to use multiple SGL accounts for every long-term procurement. It is not realistic to expect them to analyze every change order to determine if it is the result of changes in assumptions or the result of some other factor.

Financial statements are prepared at the National level of the organization. Gains and losses would have to be accounted for and reported by; field accountants and/or budget analysts, and procurement personnel that do not have financial statement experience. Multiple SGL accounts would have to be established to try to classify the gains or losses based upon the guidance contained in this ED. Even if they were able to provide the information, we do not believe that this or the other requirements in this ED will provide added benefit to managers or other financial statement users.

Selecting the Discount Rate Assumption

Question 3: *This statement proposes that the preparer provide the 10-, 20-, and 30-year market rate for Treasury securities in the notes to the financial statements as a benchmark comparison with the discount rate used by the entity. See paragraph 24 for the noted disclosure standard and paragraph A.10. as the basis for conclusions for the rationale for the disclosure of market rates.*

Do you believe that disclosure of market rates as described above is informative? Please provide your rationale in as much detail as possible.

Department Response to Question 3: The Department already discloses the range of interest rates that we use each year. As with other responses, the interest rates we use for various applications are dictated by Department/Bureau Law or by project specific law. Consequently, we have to comply with these laws, which supersede generally accepted accounting principle (GAAP) rate requirements.

***Question** 4: The statement addresses long-term assumptions that have a material effect on the reporting, for example, those used for measuring expense and liabilities associated with pensions, other retirement benefits, and post-employment benefits. The statement excludes short-term assumptions of which it provides specific examples (see paragraph 20.A.), and defines "long-term assumptions" as those involving projections of 5 years or more (see paragraph 15) and, accordingly, short-term assumptions as those involving projections of fewer than 5 years.*

4.1 Do you believe that the 5-year division between short- and long-term assumptions is appropriate?

Department Response to Question 4.1: No, the Department does not believe the 5-year division is appropriate to define long-term liabilities. The form and content requirements that must be followed for preparing financial statements require that information be presented in the statements and the footnotes as either current or non-current. Current liabilities are defined as liabilities that will be paid within one year and non-current liabilities are defined as liabilities that will extend beyond more than a year. Black's Law Dictionary defines, "A Current Liability is a business liability that will be paid or otherwise discharged with current assets or by creating other current liabilities within the next year."

The ED is addressing long-term assumptions and long-term liabilities as those that extend 5-years or more. This is contradictory to every definition we can find for long-term liabilities. We believe that the implementation of long-term liabilities as established in this ED is contradictory and will cause conflicts for financial statement reporting and preparation. This contradiction will require significant and lengthy explanatory paragraphs at a time when Federal reports are being criticized for being too voluminous.

If the FASAB insists upon the 5-year division for long-term liabilities, we feel it must be very clearly defined in the Glossary as to what situations the division/definition applies, i.e., that it is specific to pension plans and OPEB.

4.2 Do you believe the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement is appropriate?

Department Response to Question 4.2: If by default, short-term assumptions are those that extend up to but do not go 5-years, the Department finds it hard to believe that there will not be situations where large short-term liabilities could result in material gains or losses as the result of changes in assumptions.

4.3 Are "short-term assumptions" clearly delineated?

Department Response to Question 4.3: The Department believes that the term "short-term assumptions" is clearly defined in the ED.

4.4 Should other short-term assumptions be listed as examples?

Please provide your rationale in as much detail as possible.

Department Response to Question 4.4: The Department does not have any other short-term assumptions examples for this ED.

Question 5. *This statement proposes a standard for selecting the discount rates for present value measurements of expense and liability amounts. The standard provides that the discount rate should be the interest rate(s) on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rate(s) should reflect average historical rates on marketable Treasury securities rather the current market rate(s). See paragraphs 27-28 in the standard and paragraphs A11-A35 and especially A28 in the basis for conclusions.*

5.1 Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?

Department Response to Question 5.1: The Department believes that historical rates are appropriate rates to use for measuring discount rates on long-term liabilities. However, the Department/Bureaus are required to follow 18 CFR 707.39 and other project specific legislation that dictate the basis to be used for interest and discount rates with regard to planning studies and rate setting calculations. We suspect that other Federal entities have similar specific legislative requirements that will supersede the Statements of Federal Financial Accounting Standards (SFFAS) No. 5 and this ED.

5.2 How would you interpret the word "historical" in the phrase "average historical Treasury rates," for example, a 1-year average? 5-year average? 20-year average?

Department Response to Question 5.2: The Department/Bureaus have specific legislative requirements to use Treasury rates that have 15-years or more, until maturity for the Treasury rates used for many of our efforts. It is our opinion that the longer year averages will provide a more meaningful rate. The longer periods generally average out any unusually short-term peaks or valleys in rates. The Department/Bureaus deal with multi-million dollar contracts dealing with our water and power customers.

5.3 The proposed standard incorporates prior FASAB guidance regarding selecting economic assumptions. It invokes Actuarial Standards of Practice and does not affect the explicit SFFAS 5 requirement for consistency among assumptions. See ED paragraphs 33, which contains revisions to relevant SFFAS 5 paragraphs. Some observers advocate expanding the scope of the standard to provide for selecting all economic assumptions because they are concerned about consistency between the discount rate and other economic assumptions employed. Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph 33 of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions?

Please provide your rationale in as much detail as possible.

Department Response to Question 5.3: The Department's program utilizes discount rates and the other economic assumptions but in most cases, the discount rates and other requirements are dictated by legislation. Consequently, the FASAB's desire that all Federal entities utilize a consistent discount rate is not possible. Our legislative requirements supersede GAAP.

Selecting the Valuation Date

Question 6: *This statement proposes a standard for selecting the valuation date for present valuations for long-term liabilities. See paragraphs 30-32 in the standard and paragraphs A36-A44 in the basis for conclusions.*

Do you believe the valuation date approach is appropriate? Please provide your rationale in as much detail as possible.

Department Response to Question 6: The Department believes that the valuation date should be at the beginning of the year and it should be used consistently throughout the government. Because the audit completion date and the financial statement submission due dates are so close to year-end, a valuation date based upon the end of the fiscal year (FY) can result in delays in receiving information for other Federal entities. Without further dialog with our program personnel, we are not certain but we believe that Bureau law dictates the valuation date to be used in specific situations and in some cases by specific project. Again as with many of our other responses, the requirements set by law, Bureau policy or historical procedures will supersede GAAP.

Reasonable Estimate vs. Best Estimate

Question 7: *This statement involves estimates that reflect the preparer's judgment about the outcome of events based on past experience and expectations about the* *future. Estimates are to reflect what is reasonable to assume under the circumstances rather than the preparer's "best estimate" or other phraseology. The preparer may use his or her own assumptions about future cash flows. However, the entity should explain why it is inappropriate to use assumptions generally used in the federal government, as evidenced by independent sources, if the assumption the entity used is different. See paragraph 32 in the standard and paragraphs A43-A44 in the basis for conclusions.*

Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate? Please provide your rationale in as much detail as possible.

Department Response to Question 7: We do not object to FASAB changing Federal generally accepted accounting principles (GAAP) to use reasonable estimates verses best estimate.

Benefits and Costs

Question 8: *The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal.*

Please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal in whole or in part. Please provide your rationale as much detail as possible.

Department Response Question 8: The Department can support the notion that standardized requirements for employment type obligations such as pensions and OPEB will result in more consistent and concise government-wide financial statements. However, the Department cannot agree that tracking and identifying gains and losses from changes in assumptions at a component entity will improve reporting of programs that are required and managed by others with costs allocated to each component entity. In addition, the Board must address the exposure and contradiction that may result with long-term and short-term assumptions being defined as within a five year period when the long standing definition regarding current and non-current liabilities revolves around a one year period.

Implementation of this ED will require additional SGL accounts and posting model requirements to allow these assumptions and changes to be recognized and presented over multiple accounting periods. This will require additional system implementation and maintenance costs as well as additional personnel resources to manage, interpret and report on the process and the data it provides. The benefit quoted in this question is somewhat allusive and cannot be adequately analyzed to determine any specifics for comparison to costs. In fact, the Department feels the Board has ignored or discounted the costs as evidenced by their recognition of these as only "perceived costs." The Department may agree that certain aspects or elements contained within this ED could benefit by improved guidance but when combined and aggregated these will cause even greater confusion to other incidental elements such as construction, water supply and power generation.

G A O
Accountability * Integrity * Reliability
United States Government Accountability Office
Washington, DC 20548

January 18, 2008

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board

Dear Ms. Payne:

We appreciate the opportunity to comment on the Federal Accounting Standards Advisory Board's (FASAB) proposed exposure draft (ED) entitled Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates. The proposed ED would require component entities and the Consolidated financial statements (CFS) to display gains and losses from changes in long-term assumptions used to measure liabilities as a separate line item or line items on the statement of net costs. We agree with the Board that presenting this information could enhance the usefulness of information provided on the statement of net cost and provide information for users to understand the operating performance of the entity and the effect that gains and losses from changes in long-term assumptions have on program costs.

However, the guidance in the ED is not clear with respect to the application of the standard to non-actuarially prepared liability estimates, for which information required by the ED is not routinely prepared. Specifically, it is not clear how the standard would be applied to liability estimates where there is not a structured model for which changes in assumptions could be readily identified. For example, if there is an aggregate estimate that is based on management's collective judgment, it may not be feasible to identify separate components of the annual change in the liability. Also, it is not clear how routine changes in judgment would be considered. For example, if management believed that a litigation case had a probable loss of $100 at the end of the prior year and $110 probable loss at the end of the current year, how would the $10 increase in liability be classified? This would seem to be a normal operating cost. These issues arise for liabilities estimated on an individual or aggregate basis. In addition, the presentation required by paragraph 22 uses terminology that is used for reporting pension and other similar actuarial liabilities (for example, service cost). Users may be confused about how to classify annual changes in, for example, environmental cleanup liabilities or contingent liabilities using such terminology. Consequently, the Board should add disclosure guidance for non-actuarially prepared estimates to clarify the intent of the standard and to improve the consistency of application.

For liabilities composed of a substantial number of individual items, would preparers be required to identify, track and analyze changes in each individual item? Also, would the entity have to identify and segregate those individual items that are not expected to be resolved in 5 years from those that are? If so, we have concerns about whether the expected benefits would outweigh the costs that entities would incur. If such detailed analysis is intended, the Board should reconsider these requirements and clearly document the basis for its determination of whether such information can be developed at a reasonable cost in relation to its usefulness.

We appreciate the opportunity to provide our comments on the exposure draft and would be pleased to discuss our comments with you at a convenient time. If we can be of further assistance, please call me at (202) 512-2600.

Sincerely yours,

McCoy Williams

McCoy Williams
Managing Director
Financial Management and Assurance

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 1 – Tally of Responses by Question QUESTION	YES/AGREE	NO/DISAGREE	NO COMMENT
Display and Disclosure 1. This statement proposes to display gains and losses from changes in assumptions, including the discount rate assumptions, as a discrete item on the statement of net cost. See paragraphs 19-26 in the standard, paragraphs A1-A10 in the basis for conclusions, and the illustration in Appendix B, “Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions,” for more information regarding display and disclosure. **1.1 Do you believe that the display will be informative?**	5	1	1
1.2 Do you believe the standard provides satisfactory guidance as to what should be displayed as gains or losses from changes in assumptions?	5	1	1
2. The statement also proposes that the components of the expense associated with long-term liabilities be disclosed in notes to the financial statements. See paragraphs 22 and 26 in the standard; paragraph A9 in the basis for conclusions, and the illustration in Appendix C, “Pro Forma Note Disclosure of Liabilities and Expense,” for more information regarding display and disclosure. **Do you believe that disclosure of the components of expense is informative?**	5	1	1
Benchmark Disclosure 3. This statement proposes that the preparer provide the 10-, 20- and 30-year market rate for Treasury securities in the notes to the financial statements as a benchmark comparison with the discount rate used by the entity. See paragraph 24 for the note disclosure standard and paragraph A10 in the basis for conclusions for the rationale for the disclosure of market rates. **Do you believe that disclosure of market rates as described above is informative?**	2	1	4

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 1 – Tally of Responses by Question QUESTION	YES/AGREE	NO/DISAGREE	NO COMMENT
<u>Guidance re Short- and Long-term Assumptions</u> 4. The statement addresses long-term assumptions that have a material effect on the reporting, for example, those used for measuring expense and liabilities associated with pensions, other retirement benefits, and post-employment benefits. The statement excludes short-term assumptions of which it provides specific examples (see paragraph 20.A), and defines “long-term assumptions” as those involving projections of 5 years or more (see paragraph 15) and, accordingly, short-term assumptions as those involving projections of fewer than 5 years.	3	1	3
4.1 Do you believe that the 5-year division between short- and long-term assumptions is appropriate?	3	1	3
4.2 Do you believe the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement is appropriate?	4	0	3
4.3 Are “short-term assumptions” clearly delineated?	1	0	6
4.4 Should other short-term assumptions be listed as examples?			

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 1 – Tally of Responses by Question QUESTION	YES/AGREE	NO/DISAGREE	NO COMMENT
Discount Rate 5. This statement proposes a standard for selecting the discount rates for present value measurements of expense and liability amounts. The standard provides that the discount rate should be the interest rate(s) on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rate(s) should reflect average historical rates on marketable Treasury securities rather the current market rate(s). See paragraphs 27-28 in the standard and paragraphs A11-A35 and especially A28 in the basis for conclusions.	4	2 (one response is "yes and no")	2
5.1 Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?	2 = more guidance needed	1 = 5-year average is best; 1= statutory rate	3
5.2 How would you interpret the word "historical" in the phrase "average historical Treasury rates", for example, a 1-year average? 5-year average? 20-year average? **5.3** The proposed standard incorporates prior FASAB guidance regarding selecting economic assumptions. It invokes Actuarial Standards of Practice and does not affect the explicit SFFAS 5 requirement for consistency among assumptions. See ED paragraph [34], which contains revisions to relevant SFFAS 5 paragraphs. Some observers advocate expanding the scope of the standard to provide for selecting all economic assumptions because they are	3	1 = uses statutory rate	3

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 1 – Tally of Responses by Question QUESTION	YES/AGREE	NO/DISAGREE	NO COMMENT
concerned about consistency between the discount rate and other economic assumptions employed. **Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph [34] of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions?**			
<u>Valuation Dates</u> 6. This statement proposes a standard for selecting the valuation date for present valuations for long-term liabilities. See paragraphs 30-32 in the standard and paragraphs A36-A44 in the basis for conclusions. **Do you believe the valuation date approach is appropriate?**	3	1	3
<u>Reasonable Estimate vs. Best Estimate</u> 7. This statement involves estimates that reflect the preparer's judgment about the outcome of events based on experience and expectations about the future. Estimates are to reflect what is reasonable to assume under the circumstances rather than the preparer's "best estimate" or other phraseology. The preparer may use his or her own assumptions about future cash flows. However, the entity should explain why it is inappropriate to use assumptions generally used in the federal government, as evidenced by independent sources, if the assumption the entity used is different. See paragraph 31 in the standard and paragraphs A43-A44 in the basis for conclusions. **Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate?**	5	0	2

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 1 – Tally of Responses by Question **QUESTION**	**YES/AGREE**	**NO/DISAGREE**	**NO COMMENT**
Benefits and Costs and Other Comments 8. The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. Please consider the expected benefits, perceived costs, and communicate any concerns that you may have in regard to implementing this proposal in whole or in part.	1 = short list of editorial comments; 1 = supportive comment	NA	5

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 2 – Quick Table of Responses by Question

The following table provides a quick overview of the comments by question number. It omitted Question #8, the “any concerns?” question. See the table “Tally of Responses by Question” immediately above for the text of the questions.

Respondent	Q 1.1 Display	Q 1.2 Guid-ance	Q 2 Dis-closure	Q 3 “Bench-mark” Rates	Guidance re Short- vs. Long-term Assumptions				Discount Rates			Q 6 Val. Date	Q 7 “Best” est.
					Q 4.1	Q 4.2	Q 4.3	Q 4.4	Q 5.1	Q 5.2	Q 5.3		
1 FL/CPAs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No other com-ments	No	No com-ment	No com-ment	Yes	Yes
2 DoD/OACT	Yes	Yes; need more	Yes	No	Yes; need more	Yes	Yes	Yes; Add IBRN as example	Yes & No	Need more guid.	Yes	Yes	Yes
3 VA/DASF	No com-ment	Yes; need more	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment	No other com-ments	Yes	Need more guid.	Yes	No com-ment	Yes
4 DoD/AF	Yes	No com-ment	Yes; need more	No com-ment	No com-ment	No com-ment	No com-ment	No other com-ments	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment
5 FMSB	Yes	Yes	Yes; need more	Yes; need more	Yes	Yes	Yes	No other com-ments	Yes	5-yrs. is best	Yes	Yes	Yes; need more
6 DOI/FM	No	No	No	No specific com-ment	No	No	Yes	No other com-ments	Yes	Uses stat. rate	Uses statutory rate	No	Yes
7 GAO	Yes	Yes; need more	Yes; need more	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment	No com-ment

ATTACHMENT 3– STAFF SUMMARY OF RESPONSES

Table 3 – Answers and Comments by Question and by Respondent

The following table provides staff analysis and responses to the comments received and with staff recommendations, where appropriate, as well as brief summaries of the respondents' comments. The volume and length of the comment letters received is such that the members can and no doubt will use the comment letters themselves for the respondents' thoughts on the questions.

In addition to the four "Broad Issues" identified in the following table, which are developed in Attachment 4 of this memorandum, several relatively minor changes mentioned by respondent are present here that we plan to accommodate. These are identified in the table below as changes to be made "without objection from members at the meeting on February 14th", and, without objection, the staff will develop the details for these changes for the Board's consideration at a subsequent meeting.

Table 3 – Answers and Comments by Question and by Respondent **QUESTION 1**

QUESTION 1.1 – Do you believe that the display will be informative?	
Comments	The Florida Institute of CPAs (Letter #1); the Department of Defense, Office of the Actuary (DoD-OACT) (Letter #2); the DoD-Air Force (DoD/AF) (Letter #4); the AGA Financial Management Standards Board (FMSB) (Letter #5); and the Government Accountability Office (GAO) (Letter #7) agreed that the display would be informative and useful. The DoD-AF also recommends displaying more detail about the assumption change. For example, display on the financial statements the nature of the assumption change, within a category of assumptions (i.e., economic, demographic, etc.) and the amount of change. The Department of the Interior-Office of Financial Management (DOI-FM) (Letter # 6) does not believe the display will be informative or meaningful for most program agencies because the Labor Department (DOL) and the Office of Personnel Management (OPM) – that is, the administrative agencies for pensions, postretirement healthcare, and workers' compensation – calculate such costs and allocate them to the program agencies.
Staff Response and Recommendation	*Regarding the DoD-AF recommendation for additional display, please see Question #2 below dealing with disclosure, because that is where the staff's believes some options are available to be responsive to the DoD-AF comment.* *Regarding the DOI-OFM comment, staff does not recommend changing the proposed standard, because the effect of assumption changes on cost should be meaningful at the component level as well as for DOL and OPM.*

<table>
<tr><td colspan="2">QUESTION 1.2 – Do you believe the standard provides satisfactory guidance as to what should be displayed as gains or losses from changes in assumptions?</td></tr>
<tr><td>Comments</td><td>The Florida Institute of CPAs (Letter #1) and the FMSB (Letter #5) comment that they believe the proposed standard provides satisfactory guidance.

The DoD-OACT (Letter #2) comments that the five-year concept appears reasonable, but that there is some ambiguity in the wording. They suggest three improvements:

(1) explicitly allow display of gains/losses from assumption changes involving estimates for less than five years;
(2) include the size of the gain/loss relative to the actuarial liability as part of the guidance in the proposed standard (ED paragraph 21) as another criterion for deciding what to display, because they find that relationship to be very significant; and
(3) include a discussion of the need to distinguish between <u>benefit</u> changes and <u>assumption</u> changes, for example, in the ED paragraph A7 of the basis for conclusions. (Paragraph A7 explains the need for the reporting entity's judgment.)

The Department of Veterans Affairs, Deputy Assistant Secretary for Finance (VA/DASF) (Letter #3) comments that it would be useful to be clearer in the glossary regarding what is meant by "long-term assumptions."

The DOI-OFM (Letter #6) comments that they do not believe the proposed standard provides satisfactory guidance based on their belief that

(1) the standard would apply to a very limited federal audience,
(2) the use of high-level generalities diminish the standard's usefulness, and
(3) the standard should be directed to the entities that are responsible for the cost calculations, i.e., the administrative agencies.

The GAO (Letter #7) comments that the proposed standard is not clear with respect to how it applies to non-actuarially prepared liability estimates. For example, it may not be feasible to identify separate components of an annual change in the liability.</td></tr>
</table>

Staff Response and Recommendation	*The staff has no objections to the DoD-OACT and VA/DASF suggestions; and, without objection from members at the meeting on February 14, will add explanatory material for the Board's consideration at a subsequent FASAB meeting.* *Regarding the DOI-OFM comment, without objection from members at the meeting on February 14, staff will develop for reporting for the Board's consideration at a subsequent FASAB meeting, additional wording for the basis for conclusions regarding the necessity for administrative agencies to provide the cost detail for the program agencies' use.* *Similarly, with respect to GAO's comment, without objection, staff will develop for reporting for the Board's consideration at a subsequent FASAB meeting, additional wording to clarify how the standard applies to changes in non-actuarial assumptions.*

Table 3 – Answers and Comments by Question and by Respondent (continued) **QUESTION 2** **Do you believe that disclosure of the components of expense is informative?**	
Comments	The Florida Institute of CPAs (Letter #1), the DoD-OACT (Letter #2), and the FMSB (Letter #5) comment that the disclosure of components is informative. The DoD-OACT also comments that it appears the proposal eliminates the requirement in SFFAS 5, par. 88, to disclose gains/losses due to changes in the medical trend assumptions as a separate item, since now it can be included in disclosure of all other such gains/losses. *(This is not the case, as explained below.)* In that case, the DoD-OACT suggests amending SFFAS 5, par. 88. The DoD-AF (Letter #4) recommends more detail for the display of gains and losses from assumption changes. For example, display the type of assumption within a category of assumptions (i.e., categories are economic, demographic, discount rates, etc.) and the amount of each change. The DoD-AF further recommends additional note disclosure, including (1) the assumed rate of return on the plan assets, if the reporting entity has such assets – that is, not just the return on Treasury Securities), (2) the specific maturities for the Treasury Securities, and (3) the allocation of the fund's assets by asset general category. The DoD-AF also recommends requiring the reporting entity to determine its "financial position" using both the

	discount rate on Treasury securities and the discount rate on the actual assets of the fund to show the actual impact of these different rates. The FMSB (Letter #5) suggests clarifying paragraph 25 by adding the adjective "long-term" before the word "assumption". The DOI-OFM (Letter #6) comments that they do not believe the disclosure would be meaningful and informative. They believe the proposed standard is "so vague that it is hard to determine whether long-term construction contacts or procurements" would be included. They cite issues involving their SGL accounts and accounting system. GAO (Letter #7) comments that the disclosure in ED paragraph 22 is pension-oriented and may confuse users regarding how to classify annual changes in, for example, environmental cleanup liabilities or contingent liabilities. GAO recommends additional disclosure guidance.
Staff Response and Recommendation	*Regarding the DoD-OACT comment about the elimination of a disclosure regarding gains and losses from changes in the medical cost assumption, the proposed standard would not effect that requirement. Without objection from members at the meeting on February 14, staff will develop a brief explanation of the continuing requirement regarding SFFAS 5, par. 88 for the Board's consideration at a subsequent FASAB meeting.* *Regarding the DoD-AF recommendation that more detail be displayed about the nature of the assumption change, the ED proposal currently does not require as much detail on the face of the financial statement as recommended by DoD-AF. The illustration in Appendix B of the ED shows a display by assumption category, e.g., discount rate assumption. The ED's proposed note disclosure does not require detail about assumption changes but rather focuses on the change in the long-term liability.* *Regarding how to response to these comments, staff does not recommend changing the display proposal but agrees with the DoD-AF that more detail about the nature of the assumption change would be informative. Without objection from members at the meeting on February 14, staff will develop the disclosure requirement and enhanced wording for the Board's consideration at a subsequent FASAB meeting.* *The DoD-AF also recommends additional note disclosure in instances where the reporting entity is holding non-Treasury assets. Staff believes this disclosure would be informative and, without objection from the members, will develop the requirement for the Board's consideration at a subsequent FASAB meeting.* *The DoD-AF also recommends using both the discount rate on Treasury securities and the discount rate on the*

	actual assets of the fund, if any, to show the impact of these different rates. Staff believes this disclosure would be informative but that preparing two calculations would be costly and should be optional. *Regarding DOI-OFM's comment about vagueness, etc., staff references its recommendation under Question 1.2 above, which is that the basis for conclusions state the necessity for administrative agencies to provide the cost detail for program agencies to report, in instances where the former calculates the cost of long-term liability programs. The DOI-OFM question regarding whether long-term construction contracts and procurements would be within the scope of the standard would hinge on (a) whether a transaction involves a long-term liability and (b) whether the events for which assumptions are being used extend five years or more. If so, then the transaction would be within the scope of the standard. Staff believes the guidance is sufficient to answer these questions.* *Regarding GAO's comment about the ED paragraph 23 being overly pension oriented, staff believes the note disclosure requirement can be improved. Staff will develop, with objection from members at the meeting on February 14, additional guidance for the Board's consideration at a subsequent meeting.*

Table 3 – Answers and Comments by Question and by Respondent (continued) **QUESTION 3** **Do you believe that disclosure of market rates as described above is informative?**	
Broad Issue #1, Disclosure of Market Rates	
Comments	One respondent, the Florida Institute of CPAs (Letter #1) comments that they believe the disclosure of market rates would be informative and would provide transparency. However, another respondent, the DoD-OACT (Letter #2) does not believe this disclosure would be informative. Staff has identified this as an issue. **For more on issue 1, see Attachment 4 of this memorandum.**

Table 3 – Answers and Comments by Question and by Respondent (continued)

QUESTION 4

QUESTION 4.1 – Do you believe that the 5-year division between short- and long-term assumptions is appropriate?	
Comments	The Florida Institute of CPAs (Letter #1) and FMSB (Letter #5) commented that they believe the 5-year division is appropriate. The DoD-OACT (Letter #2) references their comments on Question 1.2. The DOI-OFM (Letter #6) does not believe the 5-year division is appropriate "to define liabilities". The DOI-OFM comments that such a definition is contrary to every definition they can find for long-term liabilities.
Staff Response and Recommendation	*Regarding the DOI-OFM comment, the proposed standard does not define "long-term liabilities". It uses that term in a general way essentially to describe the types of liabilities for which components of expense should be disclosed and for which valuations are undertaken using "long-term assumptions." The proposed standard <u>does</u> define long-term assumptions as those where the underlying event about which the assumption is made will not occur for five years or more. Although the respondent appears to be misreading the standard with respect to definitions, staff understands the respondent's comment to involve a question about the sufficiency of the general usage of "long-term liability" in the standard. The staff believes the general usage of "long-term liability", along with the specific focus on assumptions involving events of 5 years or more, is sufficient and therefore recommends no changes.*

QUESTION 4.2 – Do you believe the exclusion of short-term assumptions in the measurement of expense and liability amounts from the display requirement is appropriate?	
Comments	The Florida Institute of CPAs (Letter #1), the DoD-OACT (Letter #2), and the FMSB (Letter #5) commented that the exclusion of short-term assumptions is appropriate. The DOI-OFM (Letter #6) finds it hard to believe that there will not be situations where changes in short-term assumptions could not result in material gains and losses.
Staff Response and Recommendation	*Regarding the DOI-OFM comment, the proposed standard focuses on the display of changes in long-term assumptions. It does not preclude display of short-term gains and losses or other material components that the preparer believes the user should know about. The staff recommends no changes in this regard.*

QUESTION 4.3 – Are "short-term assumptions" clearly delineated?	
Comments	The Florida Institute of CPAs (Letter #1), the DoD-OACT (Letter #2), and the FMSB (Letter #5) commented that they find the term "short-term assumptions" clearly delineated.
Staff Response	*Noted*

QUESTION 4.4 – Should other short-term assumptions be listed as examples?	
Comments	The DoD-OACT (Letter #2) comments that the examples in paragraph 20.A of situations involving short-term assumptions should include IBNR.
Staff Response and Recommendation	*Staff has no objection to adding IBNR to the list of examples and, without objection from members at the meeting on February 14, will include IBNR in the list of examples.*

Table 3 – Answers and Comments by Question and by Respondent (continued)

QUESTION 5

QUESTION 5.1 – Do you believe average historical Treasury rates are appropriate discount rates for measuring long-term liabilities in the federal government, rather than current market rates?	
General Comments	
Comment	The Florida Institute of CPAs (Letter #1) comments that they do not believe average historical Treasury rates are appropriate. The Institute favors current market rates because they believe it would be a better reflection of the cost of issuing Treasury securities to extinguish long-term liabilities at the financial statement date. In addition, the Institute believes current market rates would provide more comparability and would be consistent with fair value accounting. However, the Institute comments that, if average historical rates are used, the time period should be limited to 5 years, which they feel would better reflect the current market that longer horizons. The DoD-OACT (Letter #2), the VA/DASF (Letter #3), the FMSB (Letter #5), and DOI-OFM (Letter #6) commented that long-term Treasury rates are appropriate. The DOI-OFM (Letter #6) comments that they use statutory rates and that such rates supersede SFFASs.
Staff Response and	*With respect to the Florida Institute of CPA's comment on rates, staff recommends retaining the proposed "average historical Treasury rates" for reasons stated in the basis for conclusions and will do so, without*

Recommendation	*objection from the members at the meeting on February 14.* *Regarding the DOI-OFM comment on this question and elsewhere in their comment letter that statutory requirements supersede GAAP, staff notes, for the record, the GAAP reporting and statutory reporting sometimes differ.*
Broad Issue #2, Discount Rates	
Issue 2.1 – Discount Rates – AEAN and Year-Specific Discount Rates	
Comment	The DoD-OACT (Letter #2) finds the requirement (ED paragraphs 27 and A33) to use year-specific discount rate "fundamentally" inconsistent with the Aggregate Entry Age Normal (AEAN) cost method required by SFFAS 5. Staff has identified this as an issue. **For more on issue 2.1, see Attachment 4 of this memorandum.**
Issue 2.2 – Discount rates – Investment Yields vs. Treasury Borrowing Rates	
Comment	The DoD-OACT (Letter #2) comments: "… [T]he perspective of the government's borrowing cost with the public is not necessarily relevant from the point of view of the employer entity (e.g., the DoD, in the case of the Military Retirement System) in the case of a 'funded' plan. Staff has identified this as an issue. **For more on issue 2.2, see Attachment 4 of this memorandum.**

QUESTION 5.2 – **How would you interpret the word "historical" in the phrase "average historical Treasury rates", for example, a 1-year average? 5-year average? 20-year average?**	
Broad Issue # 3, Time Period for Average Historical Rate	
Comment	The DoD-OACT (Letter #2) comments that the phrase "average historical Treasury rates" is unclear but consistent with ED paragraph 28 with respect to the need for the reporting entity to use judgment and with the

	notion of "Congressionally-established expert Boards for trust funds restricted to investing in securities that mirror marketable US Treasury securities." The VA/DASF (Letter #3) prefers more guidance regarding the time-period for and meaning of average historical rates. If average historical rates are used, the Florida Institute of CPAs (Letter #1) recommends limiting the time-period to 5 years, feeling it would better reflect the current market that longer horizons. The Institute prefers current market rates, as mentioned above. The FMSB (Letter #5) prefers a 5-year time period the discount rate, feeling that that would be a sufficiently long period. The DOI-OFM (Letter #6) comments that they have legislative requirements to use 15-year Treasury rates for "many of our efforts". Staff has identified this as an issue. **For more on issue 3, see Attachment 4 of this memorandum.**

QUESTION 5.3 – Do you believe that the guidance in the revised SFFAS 5 paragraphs (as shown in paragraph [34] of this exposure draft) is sufficiently specific regarding the necessity for the discount rate to be consistent with other economic assumptions?	
Comments	The DoD-OACT (Letter #2), VA/DASF (Letter #3), and FMSB (Letter #5) commented that they believe the guidance is sufficient. The DOI-OFM (Letter #6) comments that the discount rates are dictated by legislation and therefore consistency among federal entities is not possible.
Staff Response	*Noted*

Table 3 – Answers and Comments by Question and by Respondent (continued) QUESTION 6 Do you believe the valuation date approach is appropriate?	
Comments *Staff Response*	The Florida Institute of CPAs (Letter #1), the DoD-OACT (Letter #2), and FMSB (Letter #5) commented that they believe the valuation date approach is appropriate. The DOI-OFM (Letter #6) state that their valuation dates are set by statute and that that would supersede FASAB standards. *Again, regarding the DOI-OFM comment on this question and elsewhere in their comment letter that statutory requirements supersede GAAP, staff notes, for the record, the GAAP reporting and statutory reporting sometimes differ.*

Table 3 – Answers and Comments by Question and by Respondent (continued) QUESTION 7 Do you believe the approach regarding "reasonable estimate" rather than "best estimate" assumptions in paragraph 31 is appropriate?	
General Comments	
Comments *Staff Response*	The Florida Institute of CPAs (Letter #1), DoD-OACT (Letter #2), VA/DASF (Letter #3), and the FMSB (Letter #5) commented that they believe the "reasonable estimate" approach is appropriate. The FMSB also suggests that the Board consider adding a reference to ASOP 10 and 27 or at least to ASOP in general in paragraph A44. *Noted*
Broad Issue # 4, Comparing Preparer's Assumptions with Other Federal Sources	
Comments	The DoD-OACT (Letter #2) objects to the requirement for the entity to review assumptions used generally in the federal government as evidenced by independent sources, unless the DoD actuarial board is considered an "independent source". The VA/DASF (Letter #3) is concerned that the proposed standard, which permits the use of the entity's own

	assumptions as long as they can be justified if they deviate from independent sources, may prove inconsistent with the historical rates used in setting discount rates. They suggest this possible inconsistency be discussed in the guidance. Staff has identified this as an issue. **For more on issue 4, Attachment 4 of this memorandum.**

Table 3 – Answers and Comments by Question and by Respondent (continued) **QUESTION 8** **Please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal in whole or in part.**	
Comments *Staff Response and Recommendation*	The Florida Institute of CPAs (Letter #1) believes that overall, the proposal would improve Federal financial reporting and contribute to meeting the federal reporting objectives. It also believes that the benefits of the new display and enhanced comparability outweigh the costs. The VA/DASF (Letter #6) offers a short list of other comments at the end of their comment letter. *Staff does not object to the VA/DASF suggestions and will incorporate them, without objection from members at the meeting on February 14...*

ATTACHMENT 4 – STAFF ANALYSIS

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Overall Summary

Respondents addressed the eight specific questions present in the ED. The staff notes that the respondents generally supported the display and valuation date standards and had differing views regarding the disclosure and the discount rate proposals.

Issues Raised – Staff Analysis and Recommendations

From the comments received, staff has identified four broad issues discussed immediately below. Staff includes its recommendation with each issue. These issues and recommendations are also identified in the table in Attachment 3 above entitled "Answers and Comments by Question and by Respondent," which presents the staff's summary response to the all comments received, including staff recommendations, where appropriate.

The staff's brief summaries of respondents' comments below and in Attachment 3 provide context for staff's responses and recommendations. The limited number of comments and the length of comment letters received for this ED is such that the members can and no doubt will readily refer to them for the definitive version of the respondents' comments on the questions.

Broad Issue #1 – Disclosure of Market Rates

The Department of Defense, Office of the Actuary (DoD-OACT) (Letter #2) does not believe this disclosure would be informative. They find benchmark comparisons unnecessary and potentially confusing. They favor merely stating the basis for selecting assumptions in the notes; for example, that a board of experts decided the rates are appropriate.

> *Staff Response and Recommendation:* *Staff continues to recommend this disclosure for the reasons given in the ED's basis for conclusion, essentially that it would be a useful benchmark for comparison with the entity's rate. The ED notes that the Board decided not to require an analysis of the effect on expense and liability amounts of using current market rates but the data will help interested parties begin such an analysis.*

Broad Issue #2 – Discount Rates

Staff is presenting two issues with respect to Question #5, which was a multi-part question dealing the discount rate.

Issue 2.1 – AEAN and Year-Specific Discount Rates

The DoD-OACT (Letter #2) finds the requirement (ED paragraphs 27 and A33) to use year-specific discount rate "fundamentally" inconsistent with the Aggregate Entry Age Normal (AEAN) cost method required by SFFAS 5. They comment that, under the AEAN method, the normal cost percentage (of pay) [NCP] would not change in consecutive valuations if assumptions do not change. However, with year-specific discount rates the NCP does change if assumptions do not change. In addition, the DoD-

OACT does not believe that allowing a single rate if the "result" is not materially different, as is done in the ED paragraph 27, will sufficiently address this issue. They comment that this "would require doing the calculation under the flawed [year-specific] approach as a comparison to show the 'result' is not materially different." The DoD-OACT does not believe that year-specific discount rates should be required, even if the FASAB Board wants to allow them.

> *Staff Response and Recommendation:* *The current FASAB pension and other retirement benefits (ORB) standards for selecting cost attribution methods (paragraphs 63 and 82, SFFAS 5, respectively) direct the preparer to use AEAN (or other actuarial cost methods if the results are not materially different). The AEAN method is one of several cost attribution methods available. The private sector pension standard, SFAS 87, used another approach called "projected unit credit" (PUC). The primary reason given in SFFAS 5 for directing the use of AEAN was that the major federal pension plans at OPM and DoD were using it, and the Board was advised by actuaries that the results would not be substantially different than the unit benefit approach required by SFAS 87 (see SFFAS 5, par. 153).*
>
> *The ED proposes using a specific discount rate for each year. This is sometimes called the "yield curve" approach. As the year of payment nears, a different rate would be used to discount the future payment. The change in discount rate would be a function of (1) the passage of time and (2) the market. It would not represent a change in assumption per se in the staff's view. In other words, the discount rate does not change, the year changes. There would be a one-year rate, a two-year rate, a 5-year rate, etc., that would not (necessarily) change each year. There would be average historical rates for each year that would change when the average historical data dictated. The mere fact that a payment that was due in 5 years is now due if 4 years would not constitute an assumption change. Staff has consulted with several actuaries on this issue and does not believe that the requirement is conceptually inconsistent with SFFAS 5, paragraphs 63 and 82. Staff recommends adding a note to this effect in the proposed standard.*
>
> *Regarding the DoD-OACT comment about the ED's "if-not-materially-different-result" exception, current FASAB pension and ORB standards contain this exception regarding use of the AEAN cost approach. This provision may not have ever been used but it has never been raised as an issue.*

Issue 2.2 – Investment Yields vs. Treasury Borrowing Rates

In addition, with respect to discount rates, the DoD-OACT (Letter #2) comments "… the perspective of the government's borrowing cost with the public is not necessarily relevant from the point of view of the employer entity (e.g., the DoD, in the case of the Military Retirement System) in the case of a 'funded' plan.

- "From DoD's perspective, the plan is funded."
- "Therefore the investment yield perspective for the discount rate has relevance."
- "From the employers' perspective, the statement in [ED] paragraph A25 about the equivalence of two plans with the same benefit provisions (one funded and one not), is not necessarily correct."

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    - "From the overall federal government perspective, it is not clear what constitutes the best basis for the discount rate assumption."

- "From the overall government, or US Treasury perspective, [ED] paragraph A24's statement that the rationale for using marketable Treasury securities for the discount rate is that they reflect the government's borrowing cost with the public is questionable. A private company would not value a given future obligation at its own borrowing cost."

Staff Response and Recommendation: The respondent disagrees with the ED proposal that discount rates be independent on the employer's investments and actuarial assumptions about them. Staff believes the ED proposal is preferable for reasons stated in the basis for conclusions.

Respondent is suggesting that US Treasury rates are really employer rates. Staff disagrees with that view because Treasury rates are much broader than an individual employer's rates. In addition, in the sentence immediately below the respondent concedes the point.

DoD-OACT (Letter #2) also comments that "However, in the sense that Treasury securities represent risk-free investments, as described in [ED] paragraph A27, arguments can be made for their use as the discount rate basis.

- "In the case of US Military pensions and retiree health benefits, using [DoD actuarial] Board assumptions for the financial statement valuations make the most sense.

    - "Congress has created 'funding' in a trust fund comprised entirely of investments that mirror marketable US Treasury securities, and further has created independent expert Boards for setting the assumptions used in the valuations of these plans.

    - "The [DoD actuarial] Board assumption basis is reasonable from the employer perspective (i.e., the investment yield perspective) and is also reasonable in terms of the perspective advocated in [ED] paragraph A27 because of the nature of the trust funds. …"

Staff Response: DoD is arguing for employer perspective regarding discount rates, which is contrary to the views present in the proposed standard that call for average historical Treasury rates

DoD-OACT (Letter #2) also states, "[a]rguments that the discount rate shouldn't be impacted by the particular portfolio of securities in the trust funds at a given time, are not valid in the context of an alternative involving "a vague, undefined 'historical' average."

Staff Response and Recommendation: Staff disagrees that the average historical Treasury rates for each year would be vague or undefined. The objective was a principle-based requirement where the reporting entity would be responsible for calculating the rate. In addition, the Board asked, Question 5.2, what "average historical" would mean to the respondents in order to acquire more feedback on this issue. The Board may wish to consider additional guidance on this issue after consider issue #3 below.

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DoD-OACT (Letter #2) continues that "DoD actuarial board assumptions as to long-term yield on the trust funds is as good a basis as any to determine the discount rate, and is in fact more credible given the independence and the credentials of the DoD actuarial board members."

> *Staff Response and Recommendation: The DoD actuarial board provides assumptions for funding and, presumably, other purposes and presumably would provide assumptions for general-purpose financial statements. However, for the latter, under the proposed standard, they would look at the broader market for Treasury securities for context. Actuaries obviously work with the rules provided.*
>
> *Staff recommends retaining the general requirement for average historical rates with some additional guidance as noted in Question 5.2 immediately below.*

Broad Issue # 3, Time Period for Average Historical Rate

The DoD-OACT (Letter #2) comments that the phrase "average historical Treasury rates" is unclear but consistent with ED paragraph 28 with respect to the need for the reporting entity to use judgment and with the notion of "Congressionally-established expert Boards for trust funds restricted to investing in securities that mirror marketable US Treasury securities."

The Department of Veterans' Affairs, Deputy Assistant Secretary for Finance (VA/DASF) (Letter #3) prefers more guidance regarding the time-period for and meaning of average historical rates.

The Florida Institute of CPAs (Letter #1) comments that, if average historical rates are used, they recommend limiting the time-period to 5 years, feeling it would better reflect the current market than longer horizons. The Institute prefers current market rates, as mentioned above. Similarly, the AGA Financial Management Standards Board (FMSB) (Letter #5) prefers a 5-year time period for the discount rate, feeling that that would be a sufficiently long period.

> *Staff Response: The proposed standard does not specify a time-period for average and, thus, the Board sought comments on the question from respondents. Respondents differ as to specifying a time-period for the average. Does the Board wish to specify a time-period, e.g., 5-years? Doing so would enhance clarity, consistency and comparability. On the other hand, it would place constraints on management's choice of assumptions.*

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Broad Issue # 4, Comparing Preparer's Assumptions with Other Federal Sources

The DoD-OACT (Letter #2) objects to the requirement for the entity to review assumptions used generally in the federal government as evidenced by independent sources, unless the DoD actuarial board is considered an "independent source."

The VA/DASF (Letter #3) is concerned that the proposed standard, which permits the use of the entity's own assumptions as long as they can be justified if they deviate from independent sources, may prove inconsistent with the historical rates used in setting discount rates. They suggest this possible inconsistency be discussed in the guidance.

> *Staff Response and Recommendation:* *Staff recommends retaining the requirement. However, staff also recommends consideration of the options for specifying the GDP or other specific government assumptions with which to compare the entity's assumptions. Staff could develop options for the Board's consideration.*

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