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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

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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 **long-term** 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.

Selecting the Discount Rate Assumption

***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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