

STATE OF NEW MEXICO

Educational Retirement Board

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

via Federal Express and Email (director@gasb.org)

Re: Reporting by Cost-Sharing Employers under Proposed Amendment to

Governmental Accounting Standards Board ("GASB") Statement No. 27,

Accounting and Financial Reporting for Pensions

Dear Mr. Bean,

I am writing to comment on the Exposure Draft dated June 27, 2011 to amend GASB Statement No. 27, Accounting and Financial Reporting for Pensions (the "Exposure Draft") to require additional financial reporting by cost-sharing plans and employers. We appreciate the work that GASB and its staff have done in this area; however, we believe that a number of changes specifically in the area of reporting by cost-sharing employers are strongly warranted. The New Mexico Educational Retirement Board (the "NMERB") wishes to bring these to your attention.

The NMERB was established by the New Mexico legislature to serve as the trustee and to administer the New Mexico educational retirement system, which is a tax qualified defined benefit plan with more than 128,000 participants, retirees and beneficiaries and \$9.5 billion in assets as of June 30, 2011. The system covers all faculty and staff employees in public education, including K-12, charter schools approved either by local school districts or the state Public Education Department, community colleges, state universities, special state schools, and certain licensed educators employed at state agencies. As we understand it, the system would be a multi-employer cost-sharing plan within the meaning of the Exposure Draft. As the draft currently stands, the NMERB would currently have 201 such employers. Those employers range in size from a public school district serving over 90,000 students to one with a total elementary and high school enrollment of approximately 40 students. The universities and community colleges similarly range in size from a major public university with approximately 28,000

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students to a two year college with less than 600. Charter schools range in size from several hundred students down to approximately 40.

The New Mexico legislature, rather than the individual school districts, colleges, universities and other public educational institutions participating in the system, sets employee and employer contribution rates, retirement eligibility, and benefit formulas for the system by statute. The terms of the retirement plan are not subject to negotiation by the participating employers or employees. With the exception of a defined contribution retirement plan available on an optional basis for a limited portion of the faculty and administrators in colleges and universities, regular membership in the retirement system is required by statute as a condition of employment. All funds, contributions, and income, regardless of source, paid into or held by the system are held in a trust administered and invested for the sole and exclusive benefit of the system's members, retirees, and other beneficiaries.

Upon meeting the minimum service requirement, the state constitution provides that members of the educational retirement system acquire a vested property right with due process protections under the New Mexico and United States constitutions. Benefits are determined at retirement. However, the constitution expressly states that nothing in the section establishing the property right shall be construed to prohibit modifications to retirement plans that enhance or preserve their actuarial soundness. N. M. Constitution, Article XX, Section 22. The constitution also prohibits increases in benefits or changes to retirement funding formulas unless adequate funding is provided. Employee and employer contribution rates and retirement eligibility requirements have been increased by the legislature in 2005 and 2010, respectively; however, the retirement benefit formula has not been materially changed since 1991.

The educational retirement system currently has an unfunded actuarial accrued liability ("UAAL") estimated at approximately \$5.9 billion as of June 30, 2011. Unlike other public obligations in New Mexico, such as the State of New Mexico's general obligation bonds, which have specific maturities and debt service obligations determined at bond issuance, the UAAL is an estimate of future benefit payments, the amount and duration of which are uncertain at any point in time. The NMERB's actuaries prepare the estimate yearly based upon the demographics of members and retirees, current contribution rates, estimated future salaries and retirement benefits, rates at which new employees are being hired and existing employees retire or otherwise leave the system, and the system's assumed investment return rate. Historical data provides a basis for the estimate, but the UAAL is nevertheless subject to annual revision based on changes in the

Pending completion and acceptance of the valuation study for the fiscal year ended June 30, 2011 ("FY 2011"), the estimated UAAL is based on FY 2011 investment returns and pension liability data for FY 2010. The liability data does not appear to be substantially different for FY 2011.

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factors outlined above. In addition, legislative changes that effect contribution rates, retirement eligibility, and salaries impact the estimated UAAL.

As outlined above, the educational retirement system includes a wide variety of educational institutions. Legislative appropriations fund those institutions to varying degrees; however, those appropriations are the substantial majority, if not the entirety, of each separate institution's budget. By way of example, budgets for K-12 schools and community colleges are funded by state appropriations and some local tax revenue, which varies by district, while university budgets are funded with state appropriations, together with student tuition and fees, grants and other revenues, the amounts of which again vary from school to school. The special schools' and state agencies' budgets are basically comprised of state appropriations. State statutes do not address apportionment of the UAAL among participating employers and such a question has not been presented to New Mexico courts. Given the statutory nature of the educational retirement system and the variety of employers encompassed by the system, as well as the ability of the legislature to modify the system to enhance or preserve its actuarial soundness, the NMERB could not attempt to relate any such estimated liability to any particular employer without legislative or judicial guidance.

The Exposure Draft, however, would require that a proportion of the unfunded liability of the system, as a cost-sharing plan, and based upon projected future contributions of each employer, would appear as a liability on the balance sheet of each cost-sharing employer. We believe that such inclusion would not faithfully represent a known liability of the participating school districts and other cost-sharing employers and would be materially misleading so far as the NMERB, the State of New Mexico, and the individual NMERB employers are concerned.

We understand that purpose underlying GASB's proposal is to provide more information on public plan underfunding than may be presently available. The NMERB, like many public plans, already has made substantial information about the system publicly available to end users in its annual reports. For example, all of the NMERB's actuarial reports since 2002 are available on its website at http://www.nmerb.org/actuarialreports.htm. The system's annual reports also are posted at http://www.nmerb.org/annualreports.htm.

We also understand that another part of GASB's purposes is to provide more uniformity among such presentations, at least for accounting purposes, as evidenced by the proposed revisions to Statement No. 25, and to provide information concerning the relative participation of each cost-sharing employer in the plan. However, that rough apportioned information would be more appropriately disclosed in the notes to the financial statements of each cost-sharing employer, rather than in the balance sheet, because it would provide only some general estimation relating to the size of the system

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and the size of that employer and it would not faithfully represent any actual liability of that employer. That information, however, would be available to the public and the financial community to speculate as to what relevance it may have for the financial situation of any cost-sharing employer, the State of New Mexico, and the NMERB itself.

In addition to our concerns that including information apportioning the system's liability on employers' balance sheet would be misleading, we also strongly urge GASB to realign the information required to be included in the notes to the cost-sharing employer's financial statements, including the 10-year schedules. Such information should (1) be based on information that is readily available to the system (after any changes to the system's own accounting requirements following changes to Statement No. 25) and (2), to the extent of any apportionment calculations, that they be based on information concerning that system that can be reasonably developed by the system for its own accounting purposes, rather than special employer-by-employer information developed primarily for the employer's own accounting statements. For example, in projecting future contributions to the system, the system should be able to make any such projections as to the employers as a whole, and not have to predict which employers will have increasing payrolls, which will have decreasing payrolls, and to what degree that will occur. Not only would that be costly and time-consuming to estimate annually for the system's current-201 cost-sharing employers, it also is not at all clear that the system would be able to make such judgments with any reliability. Pension funds should not be required to take on additional reporting requirements that both increase costs and requires additional staff and management resources, especially where the information reported will be of questionable reliability and utility. Further, as is addressed below, the cost of complying with such requirements will have to be billed to the employers, most of which are financially strapped and not equipped to carry additional administrative costs when they already are being required to cut costs associated with fulfilling their primary mission - education.

As indicated above, there is a significant issue as to how the cost of developing the information required by the Exposure Draft will be borne. Internal Revenue Code Section 401(a)(2) requires that all plan assets be held for the exclusive benefit of the participants and beneficiaries. As the plan administrator and fiduciary, the NMERB can charge the cost of operating the pension fund to the plan. However, it is very questionable whether the cost of developing information to be provided to the cost sharing employers for use in preparing their financial statements can be charged to the plan as these are not expenses that are for the exclusive benefit of the participants and beneficiaries. Moreover, the suggestion that systems such as the NMERB can charge employers the costs for preparing this information does not resolve the issue of whether doing so would be a prohibited transaction between a public plan and contributing employers under Internal Revenue Code Section 503. It is critical that GASB resolve these issues before finalizing the Exposure Draft and not make accounting changes which

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may inadvertently have the effect of disqualifying public plan trusts from tax exempt status. Shifting the information required under the Exposure Draft from the inclusion of cost-sharing information for financial statements which is developed specifically for the employer involved, to inclusion in notes of information already developed by the system as part of its financial statements for the plan as a whole, apportioned if at all among cost-sharing employers only in a reasonably straightforward process uniformly applicable to each employer, would go a long way towards resolving this issue.

Finally, the Exposure Draft does not clearly address how the cost-sharing system and the cost-sharing employers will work together, if at all, to provide the additional information to be required. It will simply be impractical and cost prohibitive for both the system and the cost-sharing employers to be reviewing the same information and for the system to be dealing with each cost-sharing employer and their accountants and actuaries as to the questions or disputes that seem likely to arise. If, as understood, GASB is looking to the system, in this case the NMERB, to provide the information to the cost-sharing employers, GASB should make clear that the cost-sharing employer can rely upon information provided by the system which is reasonable on its face, and that the system does not have a duty to modify its information to suit each cost-sharing employer's own accountants and actuaries. Otherwise, again, the costs of the information would exceed any benefits derived from the information.

We hope that you will find these comments useful. We would be happy to discuss them with you further at your convenience, and please contact me if you have any questions.

Yours sincerely,

Executive Director

cc: NMERB Board members