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Letter of Comment No. 33
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Date Received: 9/30/11, SR.
CHAIRMAN, SENATE FINANCE
COMMITTEE
W. BRIAN WHITE
CHAIRMAN, HOUSE WAYS AND
MEANS COMMITTEE
MARCIA S. ADAMS
EXECUTIVE DIRECTOR

September 30, 2011

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

Dear Mr. Bean:

As director of the South Carolina Retirement Systems, I am responsible for the administration of five separate multi-employer, cost-sharing defined benefit plans that serve a wide range of employees. Membership in these plans includes teachers, police officers, state and local government employees, judges, general assembly members and National Guard members. Our plans represent more than 458,000 active, retired, and inactive members, and beneficiaries.

Thank you for the opportunity to provide comments on behalf of the Retirement Systems regarding how we anticipate Statements 25 and 27 Exposure Drafts will affect our state. We are continually looking for ways to improve our processes and achieve greater transparency, so we welcome any tools which may help us accomplish these goals. While we recognize and appreciate the extensive work the GASB has dedicated to developing these revised standards, we do have a few questions regarding their application to our pension plans.

As a participant in the GASB Field Test for the Statements 25 and 27 Exposure Drafts we have developed a better understanding of the challenges that lie ahead in terms of implementation and communication of the revised standards. Through the field test, we sampled a varied group of the South Carolina Retirement System's (SCRS) covered employers in addition to all state agencies which comprise a significant portion of our covered entities. Employers in SCRS, the largest defined benefit plan we administer, include state agencies, public school districts, and local or political subdivisions of government. We appreciate the opportunity to participate in the field test and will provide feedback to the GASB on September 30, 2011, as well.

Our primary concern is related to the application of the revised GASB standards; specifically, the methodology prescribed for determining the net proportionate liability. GASB defines the method for allocating the total net pension liability of the pension plan to the participating employers as follows (from paragraph 46 of Statement 27 exposure draft):

“The proportion used to calculate the employer’s share of the collective totals should be a measure of the employer’s projected long-term contribution effort to the pension plan as compared to total of all projected contributions of the employers.”

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As can be seen from this definition, the unfunded actuarial liability of the pension plan, which by definition is attributable to previous periods, is to be allocated to the employers based on future long-term contributions. The GASB argues in paragraphs 249-251 of the exposure draft that it believes the future contributions approach is appropriate as it represents the expected sacrifices of future resources by the employers. Not only does this method seem logically flawed, it presents cases in which a new employer joining the system will be allocated a proportionate share of the existing net pension liability even though its membership did not derive any benefit from the existing liability.

We would argue that, in practice, this allocation method appears flawed and arbitrary, and creates a situation where the employers' financial statements, prepared under the requirements of these newly proposed standards, will not accurately represent the true liabilities and financial position of the entities. We have received feedback from the employers who participated in our field test exercise that the resulting financial statement is rendered "irrelevant and non-beneficial."

The size of each employer's proportionate share of the net pension liability will distort its financial statements and call into question whether the information on the statements is useful to decision makers. Based on responses from our participating employers, the new GASB reporting requirements will make most covered employers appear insolvent, when in reality nothing will have changed from the prior reporting periods.

We are uncertain of the magnitude of the impact of this change, but given that a very large and material liability will be reported on the face of the employer's financial statements, it would stand to reason that audit costs for the employers will increase as auditors will be required to conduct additional testing to confirm the accuracy of this liability.

Another challenge which could be crippling for the Retirement Systems to attempt to enact rests in the area of valuing our investments. The exposure draft indicates that the market value of assets as of the employer's year-end date should be used in determining the net pension liability. Most pension plan investment portfolios include a diverse asset allocation with a substantial portion of alternative investments such as private equity, real estate, and hedge funds for which it is impossible to obtain a timely market value.

These assets represent investments in operating companies that are not publicly traded on an exchange and therefore current market values are not readily ascertainable. They are valued in good faith based on the most recent information available for the underlying companies and reported by the investment managers at the measurement date, adjusted for subsequent cash flows. These estimated fair values may differ from the values that would have been used had a ready market existed. Typically, such assets are valued for financial statement purposes using a quarterly lag, adjusted for current period cash flows.

We appreciate all of the dedicated work the GASB has spent developing these standards, and we especially value the intention of increased transparency and usability of financial information. However, based on our understanding of the current revised statements, these goals will not be accomplished. We thank you for the opportunity to comment in this forum and look forward to

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additional guidance and possible revisions to the current exposure drafts that will result in true transparency and usability for users of the statements.

Sincerely,

A handwritten signature in blue ink that reads "William M. Blume, Jr." with a stylized flourish at the end.

William M. Blume, Jr., CPA
Director, South Carolina Retirement Systems