



SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO

300 EAST BROAD ST., SUITE 100 • COLUMBUS, OHIO 43215-3746 • 614-222-5853
Toll-Free 866-280-7377 • www.ohsers.org

LISA J. MORRIS
Executive Director

HELEN M. NINOS
Deputy Executive Director

October 13, 2011

Director of Research and Technical Activities

Project No. 34-P, **Written Comments Regarding the Exposure Draft on Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25**

Sent via email: director@gasb.org

To the Director of Research and Technical Activities:

We are pleased to comment on the GASB's Exposure Draft on Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25. The School Employees Retirement System of Ohio (SERS) is a cost-sharing multi-employer pension system.

We disagree with the proposed Net Pension Liability (NPL). Employers in a multiple employer cost-sharing system, such as SERS, would have to report their NPL and the resulting net pension expense for all their members in the plan. There would be a disconnect between actuarial funding and accounting as it currently exists. It will literally require that two sets of books be kept, one for financial reporting and one for funding. The pension system and the employers (schools) would both have the liability reported on their financial statements. This division will not increase accountability and transparency as GASB hopes. It will make an already complicated concept even more confusing and less decision-useful. The NPL is the difference between the total pension liability and net assets (primarily investments reported at fair value). In poor market conditions, losses in market value would be reflected in lower net assets and an increase in expense. On the other hand, good market conditions would have the opposite effect with lower expenses reported. The rollercoaster effect that erratic market gains and losses will have on expenses doesn't tie back to economic reality. Pensions are financed over an employee's whole career and should be viewed in the long term, not with annual adjustments that could prove very volatile.

We also disagree with the use of a discount rate that applies (a) the expected long-term rate of return on pension plan investments for which plan assets are expected to be available to make projected benefit payments and (b) the interest rate on a tax-exempt 30-year AA-or-higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust. The expected long-term rate of return on pension plan investments should be used exclusively. A public pension system has the same goal as individuals saving for retirement – to accumulate adequate funds as efficiently as possible. A pooled plan allows investment professionals to invest in a mix of asset classes that reduce risk while maximizing returns. Using a municipal bond index will not reflect the actual investment plans. It is an overly conservative approach that will result in overstating the NPL.

The annual required contribution (ARC) would no longer be included in the financial statements. Actuarial funding and financial reporting will no longer be done in a similar manner. Instead of reporting the ARC, governments will be required to report the NPL. The ARC reflects the best estimate of the long-term contributions to be made by the employer, and it is a more stable measure and better suited for budgeting purposes. Requiring employers to report unfunded liabilities would have substantial implications on their financial statements and would be similar to requiring private-sector employers to fully account for their share of unfunded Social Security liabilities. These changes have the potential for impacting bond ratings for employers. With the use of NPL for reporting, will it be easier for employers to stop funding the ARC and just bury their required contribution in the NPL? Failing to fund the ARC would be detrimental to the employer, the other employers in the plan and the pension plan, too.

RETIREMENT BOARD

| | | | | |
|--|--|--|---|--|
| MADONNA D. FARAGHER <i>Chair</i> | MARK E. ANDERSON <i>Vice-Chair</i> | NANCY D. EDWARDS <i>Appointed Member</i> | MARY ANN HOWELL <i>Retiree Member</i> | |
| CATHERINE P. MOSS <i>Retiree Member</i> | BARBRA M. PHILLIPS <i>Employee Member</i> | JAMES A. ROSSLER, JR. <i>Appointed Member</i> | RICHARD W. SENSENBRENNER <i>Appointed Member</i> | BEVERLY A. WOOLRIDGE <i>Employee Member</i> |

We believe an employer's unfunded pension obligation should continue to be subject to disclosure in the notes to the financial statements, as required in GASB Statements 25 and 27, and not be recognized in the basic financial statements of each employer. We would suggest that additional note disclosures would be helpful to assess the plan's stewardship of funding future benefits for its members over the reporting period.

If GASB were to move forward with these proposals, we would ask that you consider a few items. First of all, a more simple calculation needs to be developed to determine employers' proportionate shares of NPL and pension expense. The use of a "projected contribution effort" would be complicated. We would suggest using an employer's payroll versus total employers' payroll. Also, as is the case for many states, if pension systems are going to be doing additional calculations for NPL and pension expense and pushing the numbers out to employers, there will be extensive additional expense. Our legislation does not currently have a mechanism that allows us to charge employers for this work. These changes would require legislation to be passed. Finally, these changes are extensive and complicated. We would ask that the effective date of the changes be pushed out at least an additional year, if not more.

In conclusion, we wish to express our overall concern with this exposure draft. Implementation of these changes would de-link pension accounting from pension funding. The elimination of the ARC would impair decision-making. The ARC creates a target for policymakers to use in funding pension costs. The ARC has promoted accountability by enabling users of financial statements to know whether or not plan sponsors are fulfilling their fiduciary obligation to properly fund the pension benefits under their purview. The ARC also helps achieve interperiod equity by charging the normal cost of plan benefits, plus an equitable portion of the cost to amortize the unfunded portion of the pension liability to each year within the plan's amortization period. The NPL, proposed to replace the ARC, would make a poor funding target due to the volatility of that number year over year. Not only would it be too large for many pension plan sponsors to fund in its entirety in any given year, but it would be subject to significant changes from one year to the next due to the fluctuations in the markets. This extreme volatility and disconnect between the measure of liabilities used for funding purposes and disclosed in the notes to the financial statements versus what would be shown on a balance sheet, will create confusion. This confusion will not be useful in public policy decision-making. Decision makers may not understand the technical differences between the actuarial results for funding and the measures proposed by GASB. This may lead them to view the actuarial results, since they are not used as the basis for financial reporting, as a less credible measure of the pension liability and required funding. We would question how these proposed changes would increase accountability and transparency of public pension systems if the reporting of plan liabilities and pension expense is calculated on a basis different than that used for funding of these pension plans.

We appreciate GASB's consideration of our comments regarding the proposed amendment of GASB Statement No. 25.

Sincerely,

School Employees Retirement System of Ohio