



Commonwealth of Pennsylvania
State Employees' Retirement System

30 North Third Street, Suite 150
Harrisburg, Pennsylvania 17101-1716
www.sers.state.gov
Office of Finance and Administration
Telephone: 717-787-7297
FAX: 717-783-1708



October 12, 2011

Director of Research and Technical Activities
Government Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Project No. 34-E

The Pennsylvania State Employees' Retirement System (SERS) has reviewed the provisions of the GASB's Exposure Draft (ED) on *Accounting and Financial Reporting for Pensions*. SERS felt the Exposure Draft Supplement most concisely addressed the relevant issues related to both the GASB 25 and 27 Exposure Drafts and therefore, we formulated our response to address the key issues presented in the Supplement. SERS would like to thank the Board for the opportunity to comment on the Exposure Draft.

SERS, which was established on June 27, 1923, provides retirement benefits to the employees of the Commonwealth of Pennsylvania and is a cost-sharing, multiple-employer defined benefit pension plan. As of December 31, 2010, SERS had \$25.9 billion of assets, had 106 participating employers, distributed \$2.4 billion of benefits annually to approximately 112,000 retirees and beneficiaries, and covered approximately 109,000 active members.

Issue 1 – Do you agree or disagree with the GASB's proposal that governments recognize the net pension liability in their financial statements?

Pennsylvania State Employees' Retirement System (SERS) agrees with GASB's proposal that governments should recognize the net pension liability in their financial statements. Pensions are a form of compensation, like salaries, which governments provide to their employees in return for service. Consequently, like salaries, the costs and obligations associated with pensions should be recorded as they are earned by the employees, rather than when contributions are made by the government to a pension plan or when benefit payments are made to retirees.

Issue 2 – How would GASB's proposal to recognize the net pension liability affect any or all of the following:

a. The usefulness of the information to the analyses we do, the work we perform or the decisions we make.

Consistent measurement of pension costs will improve the comparability of those costs among public employer financial statements. Government budgets are prepared based on projected revenue inflows and projected cash outflows and obligations. Since the net pension liability is an obligation based on past events, it would be very helpful to have information that measures the true labor costs when preparing the annual budget and making critical decision regarding use and allocation of resources. However, as in any decision, the benefit of obtaining this information must be weighed against the costs incurred.

b. Our ability to assess a government's accountability?

The entire net pension liability would be reported on the balance sheet to make readers of the financial statement aware of the liability that must be paid sometime in the future. Presently, SERS, like all governmental entities, is under extremely tight budgetary restrictions for the immediate term, and is mandated by authoritative government offices to scale back budgetary expenditures going forward. It is estimated that to comply with the GASB Pension Accounting and Financial reporting proposal, added actuarial costs to SERS budgets may be (i) close to \$100,000 (in total) through the initial application of the new statement and then (ii) more than \$15,000 annually thereafter. SERS is receptive to any recommendations the Board may have to accomplish their proposal. However, the Board must take into consideration the costs and related budgetary impact on taxpayers when establishing the requirements regarding roll-forward procedures, particularly as they apply to Cost-Sharing Multiple Employer plans with hundreds of participating employers. Please see comments in **Issue 5** below.

c. Our ability to assess interperiod equity?

We do believe the requirements under the exposure draft do improve the assessment of interperiod equity.

Issue 3 – Do you agree or disagree with GASB's proposal for how the total pension liability should be measured?

SERS does not agree with GASB's provision regarding using a discount rate that includes the municipal bond index rate. A vast majority of public pension plans, approximately 86%, use 7.25% to 8.25% for their assumed long-term rate of return on plan assets. Continuing that pattern provides greater consistency between public pension plans for comparability. Additionally, the rationale of applying the high quality municipal bond index rate to the portion of benefit payments for those employees that are expected to occur beyond the point at which plan assets are expected to be depleted is inconsistent with the "Long-Term Nature of Governments" principle. Due to this long-term nature, it is very unlikely that assets will actually be depleted. The GASB Board has noted that the experience of public pension plans over many years has been to achieve earnings that have approximated their long-term earnings assumptions.

Issue 4 – Do you agree or disagree with the GASB's proposals regarding when the factors that affect pension expense should be incorporated into the expense calculation?

SERS agrees with the GASB's proposals that governments immediately incorporate into expense, changes in the terms of the pension benefits and changes in the amount of plan assets due to projected investment earnings for all persons covered by the plan and the portions of actual economic and demographic changes differing from what was assumed related to inactive employees. This is in line with the interperiod equity principle.

SERS agrees with GASB's proposal that governments report the active employee portion of actual economic and demographic changes differing from what was assumed as a deferred outflow of resources or deferred inflow of resources and then introduce part of that amount into expense in each year of the weighted average of the remaining employment of active employees. SERS also agrees with GASB's proposal that the differences between actual investment earnings and what was projected should be deferred and incorporated into expenses over a five-year period.

Issue 5 – Do you agree or disagree with the GASB's proposals that governments in cost-sharing multiple-employer plans report a liability equal to their long-term proportionate share of their collective net pension liability?

As noted in **Issue 1**, SERS agrees with recording a net pension liability in the financial statements; however, SERS strongly disagrees with the roll forward provision in an attempt to provide the absolute latest value based on each employer's fiscal year-end.

One key factor that helps retirement systems maintain efficiency in administration of the benefits is a pooling of experience and allocation of costs among all employers in a consistent and fair manner, using reasonable approximation techniques that reflect differences in plan benefit levels among participating employers.

A major concern that cost-sharing employers have with regard to the Board's views is ensuring that employers are not overly burdened by cost increases in preparing annual valuations and reporting. It is not unusual for retirement systems like SERS, especially systems that cover a broad range of types of employees (e.g., public safety employees, legislators, judges, etc.) to have multiple sets of applicable plan provisions and a large number of separate employers. As of December 31, 2010, SERS had 7 different sets of plan benefit provisions applicable to plan members and more than 100 separate employers sharing responsibility for the overall funding of the system. Valuing a plan with this diversity in plan benefits is already costly. To incur the added time and expense required to break out the costs by employer and funds will be significant, but to add to this process the need to update that valuation to match employers' fiscal year-end is absolutely unnecessary given the materiality of the change in annual pension expense from one part of the fiscal year to another.

The net pension liability as determined by the actuary for SERS fiscal year-end of December 31 could require SERS to roll forward the collective total pension liability (as well as collective pension expense) and plan net position, at a minimum, to three other fiscal year-ends and in essence require three other "mini-valuations" throughout the year. That is assuming most employers use a calendar quarter-end for their fiscal year; more mini-valuations could be required if certain employers use mid-quarter valuations. Costs will increase significantly if the pension system must provide such mini-valuations for each individual employer's fiscal year-

end, and these costs are not justified by any comparable increase in benefits to the reporting entities.

To give the Board some concept of what this may involve regarding measuring SERS plan net position throughout the year, SERS has approximately 400 limited partnerships that are reported on a quarter lagged basis. Our December 31 audited statements include December 31 values for approximately 90% of these limited partnerships. Since these values are audited at our year end, very clean cutoffs are made regarding making all accruals and measuring year end valuations based on our partnership's audited financial statements. These values would be very difficult to update in this manner at any other time throughout the year and would be extremely burdensome, and costly to the system's accounting and back office investment functions. These limited partnerships comprise 35% of SERS invested assets as of December 31, 2010. From a materiality standpoint, regarding how much the valuation will change in perhaps 3 months and 6 months in most cases, SERS questions the relevance and value of requiring the roll forward calculations.

Based on SEC Bulletin 99 and FASB Under FASB Concept Statement No. 2, both quantitative and qualitative factors should be considered when assessing materiality. FASB Concept Statement No. 2 defines an omission or misstatement of an item in a financial report is material if it is probable that the judgement of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item. The relevant question here is, given the size of most pension liabilities and the consistency of pension expenses from year to year, will any decision makers be influenced by the change in valuation resulting from the roll forward over 3, 6 or 9 months. Given that the budgeting process occurs annually and in some states bi-annually, the decisions made based on information from a 12/31 valuation, would not differ that much from an updated valuation 6 months later. Additionally, the valuation on 12/31 would be based on audited financial statements with a clean GAAP accounting cutoff, where the rolled-forward valuation would not be.

SERS' position is that the annual actuarial valuation that is performed would not change materially for the employers' liability and expense from December 31 to the roll forward period. Therefore, SERS proposes that the GASB allow the December 31 valuation to be used for accounting and reporting without the required roll forward procedures. If there are significant changes that have occurred between the preceding December 31 and the date of the employers fiscal year end, a subsequent event footnote should be disclosed as is done during financial statement preparation now.

Issue 6 – Do you agree or disagree with the GASB's proposals regarding note disclosures and RSI?

SERS agrees with the GASB's proposals regarding note disclosures and Required Supplemental Information (RSI). With the significant changes proposed and the volatility of net pension liability and pension expense, detailed note disclosures and RSI will be necessary to show what changes are occurring. The ten-year history will also show relevant trends if they exist. However, this will result in much higher administrative costs for the pension system because all of this information has to be provided by the actuary for each of the employers in the plan. SERS questions the cost/benefit of this proposal. If the provision remains, SERS feels strongly that the ten-year history should be built prospectively over the ten years following

implementation, not required retroactively. Retroactive application would obviously provide a large additional cost without a comparable benefit.

Issue 7 – Do you agree or disagree with the GASB’s proposals regarding special funding situations?

SERS does not have any special funding situations.

Issue 8 – Do you agree or disagree with GASB’s proposals regarding governments participating in defined contribution pension plans?

SERS offers a Deferred Compensation Plan (DCP) under Internal Revenue Code section 457(b) retirement plan for eligible government employees and officers. The program is a voluntary tax-deferred supplemental retirement plan. As such, this plan is not covered by the GASB proposals.

Issue 9 – Other Comments:

Under the current language, PA SERS would need to implement these changes as of their 12/31/2013 actuarial valuation to provide information to most employers whose year end is 6/30/2014. SERS employers have multiple classes of employees and multiple reporting funds within numerous single agencies and across multiple agencies. Additionally, SERS’ current funding actuarial model is based on a variation from entry-age and is using level dollar amortization. Given the complexity and magnitude of these major changes that need to be made to SERS’ valuation model and to SERS and SERS’ participating employers’ information systems to send and capture new demographic data needed to break out the individual net pension liabilities across all 106 agencies, SERS is strongly urging the Board to delay implementation for at least one additional fiscal year.

Sincerely,



Anthony J. Faiola
Chief Financial Officer
State Employees’ Retirement System
717-237-0315
E-mail: afaiola@pa.gov