



Ohio Public Employees Retirement System

October 14, 2011

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

RE: Project No.34-E Pension Accounting and Financial Reporting

Dear Board and Staff:

The Ohio Public Employees Retirement System is pleased to have the opportunity to respond to the Governmental Accounting Standards Board (GASB) Exposure Draft (ED) document on "Accounting and Financial Reporting for Pensions an Amendment of GASB Statement No. 27".

Overview of OPERS

The Ohio Public Employees Retirement System (OPERS or the System) is a multiple employer cost sharing system that includes members in all facets of public employment. Employees of 3,700 employers are categorized into one of four divisions based on the functions performed: state or local government, public safety, and law enforcement.

Each of these four divisions has different contribution rates, retirement eligibility rules, and pension benefit formulas, which are defined in Ohio state statutes. However the benefits of these divisions are funded out of a single trust specific to the plan the member elects. A change to these contribution rates and / or benefit rules requires legislative action. Employers do not have control over the pension benefits their employees will receive or the contribution rates they and their employees are required to pay to fund these benefits. In addition, employers do not have the authority to "opt out" of participation in the OPERS provided benefits.

OPERS provides pension benefits through three pension plans:

- A pure defined benefit plan in which employee and employer contributions are used to provide a formula benefit on retirement,
- A pure defined contribution plan in which the employee and employer contributions are deposited into a member's individual account and the investment of these funds is managed by the member, and
- A hybrid plan in which employee contributions are deposited to a defined contribution account and the employer contributions are used to fund a (reduced) defined formula benefit.

The future retirement benefits of a member in the defined benefit plans are based on the member's career service credit across multiple employers. Based on OPERS membership, the average member has service with multiple employers. In addition, members with service in other retirement systems may retire under OPERS if their OPERS covered service represents the largest component of their career. In these cases, OPERS receives the contributions paid to the other Ohio retirement systems plus interest, however the value is not actuarially neutral compared to the benefits to be received.

Members have the option to change plans during their career, however defined benefit account balances cannot be transferred to a defined contribution plan. Defined contribution account balances can be used to purchase the corresponding service credit in a defined benefit plan. In addition, members have the option of using their defined contribution accounts to purchase a defined benefit annuity at retirement. This election is known only at retirement.

In the unlikely event of a plan termination or default, the state legislature would determine the final dispensation of any unfunded liability.

Concerns with the Exposure Draft

- **Comments on Proportionate Share of Pension Liability and Expense**

Multiple Employer Cost Sharing Systems vs. Agent / Single Employer Systems

We understand that the GASB has given considerable thought to the application of the proposed standards to agent and single employer plans, and in these instances the standards will result in an appropriate recognition of a liability under the control of the employer.

The same is not true of multiple employer cost sharing plans which function more like an insurance contract. In exchange for the payment of contribution rates as set in statute, members of the participating employers are guaranteed a formula benefit upon retirement. The cost of these future retirement benefits is pooled, much like the risk pool of an insurance company, and cannot be separated with reliable accuracy to reflect the actual experience of a given employer.

The allocation of the aggregate liability to participating employers will result in pension expense and net pension liability values that lead users to believe in a greater level of accuracy and dependability than truly exists. Additionally, these values will be extremely difficult to explain and potentially misleading to users of the employers' financial statements. Because the participating employers have no control over either the contribution rates or pension benefits, we question the extent to which these disclosures depict a faithful representation of the effects of the employers' governmental activities, or how the disclosures support the needs of decision makers.

Multiple employer cost sharing plans are akin to Social Security where the payment of employee and employer contributions purchases a social security annuity; and in Ohio, OPERS is a replacement for Social Security for public employees.

State Statutes

Ohio statutes hold employers liable for only the contribution rates established by the legislature in statute. In the unlikely event of a plan termination or default, the state legislature would determine the final dispensation of any unfunded liability. OPERS, not the participating employers, is required to report to the legislature on contribution rate and benefit changes for legislative consideration and action, positioning the pension system to be in control of these variables. The assignment of the liability to employers can be misleading given the structure within Ohio, and raises a question regarding the application of accounting standards that are not in accordance with state statutes.

Implementation of the proposed standards will also be a costly undertaking by OPERS through additional audit and actuarial services, as well as internal staff resources in communicating the required disclosures to participating employers. References have been made by the GASB that these costs could be billed to the employers. However, state statutes do not permit OPERS to bill employers for amounts other than the contribution rates established in statute. Case law related to the pension systems has also ruled that the Ohio retirement systems have no authority beyond

what is conferred to them under their governing statutes. Accordingly, OPERS would be responsible for paying these additional costs, which could be construed as a violation of Internal Revenue Code's "exclusive benefit rule" (IRC 401(a)(2)).

Allocation Process

The proposed standards allocate the net pension liability to employers based on the projected long term contributions of the employer as a ratio of the total projected long term contributions of all employers. This allocation method will result in disproportionate shares of the pension expense and liability being allocated to smaller general government employers with a stable workforce. For example, OPERS has over 1,700 employers with a workforce of 10 employees or less.

Under the proposed allocation method, all employers share in the liabilities arising from workforce downsizing, dissolution of a governmental entity, and / or privatization of governmental functions, as well as the liabilities arising from employees from other Ohio retirement systems who retire under OPERS covered benefits. When a governmental entity is dissolved (as has happened in Ohio), there is no payment of the unfunded liability by the entity or other type of termination benefit calculation. Instead, the pension liability for these former employers is shifted to the remaining employers in the fund.

In addition, the allocation process aggregates the pension liabilities of all employers in the defined benefit plan, and results in state and local employers sharing in the liabilities of public safety and law enforcement personnel who retire at younger ages with enhanced benefits.

The shared pooling of pension expense and net pension liability that is not reflective of actual employer experience limits the usefulness of this information to users of governmental financial statements and to decision makers within the governmental unit.

Summary

Unlike agent or single employer systems where the member's pension benefits are based solely on the member's service with that employer, pension benefits in a multiple employer cost sharing plan are based on a member's collective service in all OPERS covered employer positions. This service frequently spans multiple divisions, employers, plans, and even multiple systems. We believe it is theoretically incorrect to treat cost sharing multiple employer systems as if they are simply agent multi-employer plans.

- **Comments on Reporting at the Employer Fiscal Year End**

OPERS Year End Processes

OPERS processes are designed around an annual reporting cycle. Our year end close process includes the valuation of investments at fair market value, the accrual of employee and employer contributions, and the allocation of administrative expenses among the three pension and two health care plans.

OPERS employers have varying payroll cycles ranging from weekly, biweekly, monthly, quarterly, and in some cases, annual payrolls. In addition, by state statute employers have until the end of the month following the pay period end date to remit contributions. The variability of reporting cycles makes accruing contributions on a monthly basis a subjective process. Special procedures are implemented only at year end to project these revenues. Attempting to implement these procedures on a monthly basis would add significantly to the time and cost of closing our books.

The valuation of investment assets such as private equities and real estate also cannot be realistically done on a month end basis. Inconsistent approaches to investment values and expenses reduces

the usefulness of this comparative data, and can result in disproportionate allocations of pension expense and net pension liability based solely on the employer's fiscal year end date.

Information Technology and Resource Demands

The proposed standards are complex and extremely costly to implement. OPERS does not currently collect employer data at a level required to fulfill the requirements of the Exposure Draft. As noted above, the movement of members and their corresponding service across multiple divisions, employers, plans and even systems adds complexity to the required system infrastructure changes. Significant information technology changes will be necessary to store employer fiscal year end dates and component unit reporting relationships. Because OPERS systems are designed around a calendar year end, significant changes to core systems will be necessary to accommodate a monthly reporting cycle. Additional challenges involve systems and actuarial services necessary to "roll forward" the pension liabilities and plan assets to the employer's fiscal year end, and to communicate the necessary date to participating employers.

Plan Disclosures

OPERS will need to prepare the asset related note disclosures for each employer fiscal year end to determine if any significant changes have occurred. This review would need to include disclosures related to derivatives, securities lending, interest rate sensitivity, credit, foreign currency, and custodial credit risk. It is not clear to what extent subsequent events at the plan level would need to be disclosed by the employers, however the effort involved in the development of these disclosures will significantly delay employer communications.

Audit Concerns

The variability (and volatility) of data based on multiple employer year ends will require audit procedures to satisfy the needs of our 3,700 state and local government employers and their external auditors. Based on our employers' year ends, we anticipate OPERS would have to prepare a "roll forward" for all twelve calendar months, with corresponding support to our employers' auditors. It is likely that OPERS will need a SSAE16 audit of the allocation of pension expense and liability on a monthly basis, resulting in a significant increase in audit fees.

Timeliness

Many of our employers complete their year-end close process within 3 months of their fiscal year end. Delays inherent in the valuation of alternative investments and the need to perform year end close procedures on a monthly basis will not permit OPERS to provide employers with the required disclosures in time to meet their annual / fiscal year-end financial reporting deadlines.

- **Complexity / Other Concerns**

As OPERS participated in the field test to implement the proposed standards, additional concerns were identified regarding the complexity of the proposed disclosures that require clarification or amendment.

Classes of Covered Employees

As noted in the overview, OPERS offers three pension plans: a defined benefit, defined contribution, and a hybrid plan. Members may "switch" between plans during their employment career, leaving their prior contribution history with the former plan, or in some cases purchasing the corresponding service credit in the defined benefit plans. The definition of active, inactive, and retired members varies depending on whether employees are viewed at the System, Plan, or employer division level. Ohio law also allows public employees who retire to return to OPERS covered service while still

receiving a retirement benefit from their prior career service. These employees are “retired” from their primary career, but “active” in their post retirement position, earning a future annuity under a different annuity formula.

The ability of members to change plans during their career, switching from defined benefit to defined contribution or vice versa, and the option of post retirement employment makes the projection of long term contributions as an allocation base problematic at the defined benefit plan level. This issue is also apparent when employers privatize functions or public entities are dissolved.

Actuarial Issues

A number of questions / issues regarding the actuarial values were identified during the field test. Employer expectations are that OPERS will provide all the values necessary for their disclosures, however OPERS will not be in a position to identify “significant changes” at the employer level.

Paragraph 60 describes how a change in proportionate share is calculated and maintained individually for each employer year end. Attempts to implement this process during the field test indicate an extremely onerous and unwieldy requirement for large systems such as OPERS with over 3,700 employers. We would have to maintain a separate amortization schedule for each employer and each succeeding year end.

The actuarial data and weighting requirements necessary to meet the employer level reporting requirements of the Exposure Draft could be cost prohibitive with no clear benefit to financial statement users.

Discount Rate

It is not clear if the blended discount rate is to be calculated at the plan’s fiscal year end or recalculated at each employer year end. Calculating the blended discount rate for each employer year end is a time consuming calculation with questionable added value.

Hybrid Plans

The OPERS hybrid plan contains elements of a defined benefit and a defined contribution plan, but is a legal entity in total. The Exposure Draft is unclear as to how these plans are to be reported. The GASB response to initial queries regarding these plans is that the plan should be bifurcated into separate defined benefit and defined contribution components. This becomes problematic on a number of levels. Within the OPERS Comprehensive Annual Financial Report (CAFR), the hybrid plan is reported as an entity in its entirety. Splitting the plan disclosures into separate defined benefit and defined contribution components makes it difficult to relate the disclosures back to the plan level reporting in the financial statements. In addition, expenses associated with administration of the plan belong to the plan as a whole and cannot be realistically allocated to the defined benefit or defined contribution components of the plan.

Defined Contribution Plans

As noted in the overview, members of a defined contribution plan can elect to annuitize their defined contribution accounts as a defined pension benefit, however this election is known only at retirement. Actuarial projections of future defined benefit pension expense would result in employers sharing in potential defined benefit liabilities accruing to defined contribution plan members, further distorting the net pension liability.

Plan Administrator as an Employer of the Plan

OPERS is both the administrator of the pension System and a participating employer in the pension plans of the System. The administrative expenses of OPERS (as the plan administrator) are an

expense of the pension trust. However, as a participating employer, OPERS would also share in the pension expense and net pension liability of the System. The allocation of pension expense and net pension liability to OPERS as a participating employer, and by extension back to the pension trust as the administrator, is confusing. Further guidance is needed on this issue.

Field Test

Due to time constraints and ambiguities in the Exposure Drafts, OPERS was not able to conduct a comprehensive field test. A simplified approach was adopted that included only one pension plan (the pure defined benefit plan) using values already determined and reported in the December 31, 2010 CAFR. No testing of year end close procedures to be performed on a monthly basis, valuation of investment assets, or roll-forward procedures were included in the test. Accordingly, the estimated impact and projected costs are likely to be grossly understated.

Feedback received from employers participating in the field test with OPERS raised additional questions regarding the allocation of pension expense and net pension liability to enterprise and proprietary funds. The Exposure Draft includes this requirement but does not provide a recommended practice. OPERS is not in a position to advise our employers regarding this additional allocation.

We strongly encourage the need for a full field test including a field test involving users of the financial statements to determine the extent to which the proposed standards meet their needs. The full field test should include consideration of the cost to implement compared to the intended benefits of the proposed disclosures.

Recommendations

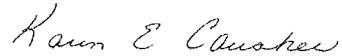
While we understand the intent of the new reporting requirements in the GASB Exposure Drafts, we would like to offer the following recommendations as the Exposure Drafts relate to multiple employer cost sharing plans:

- 1) Report the aggregate pension expense and net pension liability on the face of the financial statements of the pension System, with potential note disclosures in the financial statements of the participating employers. This approach places the pension liability with the entity that has the most influence over employer contribution rates and pension benefits, consistent with state statutes.
- 2) If it is ultimately deemed essential to provide readers with a perspective on an estimated allocation of the pension liability to employers, a simplified disclosure might be to note in the employers' disclosures the total system liability and the percentage of employees or contribution value (based on total payroll) for that employer relative to the total. Readers can estimate a sense of the employer's relative participation in the aggregate liability without the detailed disclosures that infer more credence than actually exists.
- 3) If the standards are not amended to permit the reporting of the aggregate pension liability on the financial statements of the pension System, we recommend that at a minimum, the procedures requiring the roll-forward of pension expense and pension liability to the employer year end be amended to report this information at the fiscal year end of the pension System only. We believe very little benefit is gained by the roll-forward process compared to the cost involved in fulfilling this requirement.
- 4) The complexity and implementation concerns associated with the proposed standards are significant, and will require an implementation period of more than one year. We recommend that the proposed standards be fully vetted for multiple employer cost sharing plans, and the proposed effective date be delayed to permit implementation of the necessary information technology systems and procedures.

- 5) Finally, we strongly urge the GASB to evaluate the decision usefulness of the proposal as it relates to cost sharing systems, relative to the significant additional costs that will be incurred to implement and the ongoing cost of compliance.

We appreciate the opportunity to comment on the Exposure Drafts, and the opportunity to testify at the October 13, 2011 hearing. Questions may be directed to Karen Carraher, Executive Director at 614-222-0011, or to Charlene Powell, Assistant Director – Financial Reporting at 614-225-8998.

Sincerely,



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Executive Director, OPERS