



Missouri State Employees' Retirement System

Mailing Address
PO Box 209
Jefferson City, MO 65102-0209

Office Location
907 Wildwood Drive
Jefferson City, MO 65109

May 13, 2015

Mr. Leigh Snell, Director of Federal Relations
National Council on Teacher Retirement
9370 Studio Court Suite 100E
Elk Grove, CA 95758

Dear Leigh:

In listening to your April 30, 2015, webinar regarding covered payroll, it occurred to me that it might be useful for those involved in the current discussions to have a summary of the evolution of the required supplementary information included in Public Employee Retirement System (PERS) financial statements.

In the 1970s there was considerable activity related to developing appropriate reporting and disclosure standards for the financial activity of public employee retirement systems. This was in part being driven by congressional interest in expanding provisions of ERISA to public sector plans and the thinking that the end result would likely be better if it came from practitioners rather than congress.

GFOA (then MFOA) had their Certificate of Conformance program (now called the Certificate of Achievement for Excellence in Financial Reporting). A committee was formed, consisting of actuaries and auditors who had considerable public plan experience together with a number of public retirement plan directors. The committee's challenge was to review what was presently in place and determine how it might be improved. Currently we talk about decision usefulness in financial reporting. While similar in outcome, back then we thought in terms of red-flag reporting. That is, what would alert informed users that problems were emerging that would prompt decisions to remedy those problems?

At that time, the Comprehensive Annual Financial Report (CAFR) for a governmental entity consisted of an introductory section, a financial section and a statistical section. The committee reviewing this matter quickly determined that a PERS CAFR needed to be expanded to include an actuarial section. The thinking here was that information regarding both depth and flow needed to be presented. The depth was provided by the single point in time information included in the financial section and the flow could be presented in the form of trend data prepared by the actuary. In 1980 MFOA published Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report calling for the addition of an actuarial section to CAFRs. The actuarial trend data required is illustrated in the attachment.

When the guidelines were published, Generally Accepted Accounting Principles (GAAP) were not clear for public retirement systems or for public employers reporting on pension matters. Pronouncements from the National Council on Governmental Accounting (NCGA) and the Financial Accounting Standards Board (FASB) conflicted significantly. Both NCGA and FASB based financial statements were illustrated in the guidelines but neither stipulated that Required Supplementary Information (RSI) was to be included with the financial statements.

Furthering the jurisdictional dispute, the NCGA issued Statement 6, Pension Accounting and Financial Reporting: Public Employee Retirement Systems and State and Local Governmental Employers in 1983. Statement 6 included a requirement that ten-year statistical trend data was to be included with the financial statements and that data was virtually identical to what was required to be included in the actuarial section of a PERS CAFR based on the PERS CAFR Guidelines. Application of NCGA Statement 6 and FASB Statement 35 were deferred pending resolution of the jurisdictional issue regarding which body was to establish GAAP for governmental retirement plan reporting and disclosure.

As mentioned earlier, the focus was on red flag reporting. A significant red flag would have been the situation where employer contributions differed from the amount recommended by the actuary. While the term “covered payroll” could have been clearer, it was generally understood that the actuary was developing contribution rates based on the payroll used for benefit determinations and that the actual contribution should be stated on that same basis for comparability purposes.

Once the jurisdictional dispute was resolved with the establishment of the GASB in 1984, an initial GASB project involved clarification of reporting for PERS which led to GASB Statement 5, Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Government Employers. Statement 5 closely followed the provisions of NCGA Statement 6 but it was with GASB Statement 5 that the term “Required Supplementary Information” was first introduced. GASB Statement 5 also included the following definition of Covered payroll:

As used in this Statement, the term covered payroll refers to all compensation paid to active employees covered by the PERS on which contributions are based. Covered payroll may also be referred to as “covered compensation.”

This definition was modified slightly with GASB Statement 25 issued in 1994 to read as follows:

All elements included in compensation paid to active employees on which contributions to a pension plan are based. For example, if pension contributions are calculated on base pay including overtime, covered payroll includes overtime compensation.

While different plans may have different definitions of compensation, I have not encountered a situation in which one definition is used for determining obligations and another definition is used for determining either the ARC or the new ADC. Reporting liabilities and contributions that were determined on the basis of pensionable compensation and then reporting a total compensation number that has no relationship to either has extreme potential for misleading inference.

Practical Consideration

Employer reporting systems and retirement system data maintenance systems have been developed around pensionable compensation. Requiring employers to report two different payrolls and requiring retirement systems to maintain data on those different payrolls would be a monumental and very expensive undertaking in terms of system modifications. It would be a different matter if decision usefulness could be improved based on such reporting. However, it is difficult to conceive of a situation where it would be useful to report information that can lead to the conclusion that the employer contribution to the plan as a percent of payroll is different from the percent of payroll contribution rate recommended by the actuary. The employer could be contributing exactly the amount recommended by the actuary but appear to not be doing so.

It would be reasonable to ask why I did not object to the change in the definition of covered employee payroll in the exposure draft of what became Statement 67. The fact is that I missed it which I suspect was the case with many people. In reading the Implementation Guide for Statement 67, the context in which the term covered payroll is used appears to me to reference the payroll used by the actuary in computing the total liability and, ultimately, the payroll to which the contribution rate would be applied in determining the employer contribution. It simply never occurred to me that payroll which is unrelated to either liability accruals or contributions would be introduced as a disclosure item and compared with values derived from a different payroll number.

Sincerely,



Gary Findlay

PS: The focus here has primarily been on pensionable compensation. If you are interested, attached is an article that provides additional information about the evolution of overall accounting and reporting standards related to public employee retirement.

cc: Dave Bean
Michelle Czerkawski
Rob Wylie, NASRA Representative to GASAC