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STATE RETIREMENT
and PENSION SYSTEM

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R. Dean Kenderdine
Executive Director
Secretary To The Board

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The Honorable Jim Moran
President, Board of Commissioners
Queen Anne's County
107 North Liberty Street
Centreville, MD 21617

Dear Commission President Moran:

Since January 2014, I have been in communication with your government's finance, accounting, and human resource personnel concerning the new accounting standards for public pension plans, issued by the Government Accounting Standards Board (GASB). Through this effort we have provided your staff with the information and guidance needed for your financial statement's compliance. While the effort has been challenging indeed, I want you to know that our relations with your staff have remained positive throughout.

I wanted to take this opportunity to explain all that has gone into the approach we have taken in implementing the new standards.

Under GASB Statements No. 68 and 71, state and local government entities now have to report the difference between the total pension liability (determined by the pension plan actuary as the future cost of retiree benefits, discounted into today's dollars) and the current market value of that plans' investments held in a defined benefit trust. In many instances, this will result in the recordation of a liability (i.e., the actuary-determined total pension liability is greater than the current value of assets). Under the new GASB standards, this is known as the Net Pension Liability (NPL).

For a single employer plan (i.e., one employer providing a pension plan to its employees), the accounting is a one to one relationship with the actuarial valuation and market valuation of assets. Specifically, the net pension liability amount that is included in the actuarial valuation is the same amount that is recorded on the financial statements. The Maryland State Retirement and Pension System (the "System") is not a single employer plan, but rather a *single multiple-employer cost sharing plan*. Your government is one of those employers.

Accounting for each employer in a cost sharing plan is more difficult. GASB requires that employers participating in a cost sharing plan report their respective share of the NPL of the plan. The new GASB standards permit this allocation to be based on each employer's total annual contributions into the plan in order to allocate the NPL of the respective plan. For example, if you contribute 1% of all contributions to the plan, you would be allocated 1% of the net pension liability.

The Maryland System presents further challenges in the implementation of GASB No. 68. This is because the System has been historically *accounted for* as a single multiple-employer cost sharing plan. As such, since the adoption of the first GASB standards for public pension plans (GASB No. 27, first required in 1998, and replaced by GASB No. 68 this year) the System has received an audit as a *single entity.*

Statutorily, the System is made up of seven plans, the Employees' Retirement, Employees' Pension, Teachers' Retirement, Teachers' Pension, State Police, Judges', and Law Enforcement Officers' (LEOPS). Also under statute, the assets for these plans are held in five separate asset pools - the assets for the two Employees' plans and the two Teachers' plans are combined to make up two of the five pools.

The split of assets between the seven plans or the five pools *has never been audited* at the plan level. The assets have historically been audited only in the aggregate. It has not been required that the individual plan assets be presented as audited information in the basic financial statements.

The question has been raised as to why the State liabilities and the participating governmental units' liabilities aren't segregated for this GASB calculation purpose. After all, each year when the System's actuary determines the contribution rates that determine the dollars needed from each participating government, those dollars go into a separate pool for those governments.

The answer is entirely due the fact that, as stated above, the System's assets are not, and never have been, audited at the plan (Employees' and LEOPS) level. It is not possible to audit the plan's assets since inception. Without such audit records, it would be impossible for the State's auditor, and subsequently each participating government's auditor, to give either entity's financial statements, an unmodified opinion.

Therefore, given these circumstances for the Maryland System, we have calculated the NPL amounts on a single plan basis to allow participating government units to adopt the new GASB standards based on the System being a single multiple employer cost sharing plan. As such, it has been necessary for *total* contributions – those made by the State <u>and</u> those made by the participating local employers – to be used to allocate the NPL.

To calculate the individual NPL amounts for each participating governmental unit, the System used the total FY2014 actuarial determined *State* contributions (inclusive of local Teacher Pension System contributions) plus the total FY2014 contributions made by all participating government units. Since the State's actual contributions to the System were less than what was actuarially required, the System used the *actuarially required amount* to ensure that the State and Participating Government Units were on equal footing as the NPL amounts were calculated. As a result, in that the State contributes approximately 92% of the contributions, it was allocated 92% of the liability. Participating government units contribute approximately 8% of the total contributions, and thus were allocated 8% of the liability on a proportional basis. NPL amounts were determined on the basis of each government's actual contributions to the System.

I hope this letter has been helpful in laying out the method and basis for the manner in which the System has gone about making these new GASB calculations for each of its participating governmental units. Please feel free to contact me if you would like to discuss the matter further either by telephone (410-625-5600) or a meeting in your offices.

Sincerely,

R. Dean Kenderdine
Executive Director

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