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Continual Awareness Regarding Public Pension Reform

By Marilyn Mays, CPA, CGMA

Until recent years, many public officials, government finance officers and government employees didn't have a good understanding of the financial aspects of public pensions. But with the Great Recession came the realization that the financial strength of a public pension is not someone else's responsibility. After a few years of numerous pension headlines as well as the financial impact on both employers and employees, public officials and employees now understand the financial health of their pension plan is the responsibility of all members and participants of the plan. Many government employers and employees in Arizona participate in either the Arizona State Retirement System (ASRS) or the Public Safety Personnel Retirement System (PSPRS). As with most public pension plans in the United States, the ASRS and PSPRS plans are underfunded and both plans have made significant changes to improve the financial condition of the plan.

Pension plans are funded from contributions and investment earnings. Contributions for most plans are shared between the employer and employee. Pension contributions and investment earnings made up 37 and 60 percent, respectively, of total pension revenues for the 30-year period from 1985 through 2014. So a significant loss in investment earnings would dramatically impact the financial strength of pension plans. Late 2007, the beginning of the Great Recession, marked the initial decline in economic activity in which investment values dropped to record lows. The Federal Reserve reported State and Local Government Employee Retirement Funds' total financial assets declined from $3.2 trillion at the end of 2007 to $2.1 trillion by March 2009. After losing over 34 percent of the entire net worth, pension plans were forced to increase revenues from the only other major revenue source which was contributions. Unfortunately for most plans, a significant increase in contributions would not generate enough to sustain the plans' financial health.

Pension plans were forced to consider decreasing costs by adjusting retirement provisions. The objective of any pension plan reform is to be fair for all stakeholders involved which includes employees, taxpayers and employers. Retirement plan reform focused to ensure competitive compensation that includes income security in retirement for employees, to provide public services that are performed in the most effective and cost-efficient manner for taxpayers, and to provide employers a management tool to maximize the training and experience invested in their employees. Most reforms of pension plans modified the required employer/employee contributions, benefits level, and/or eligibility for retirement. Many changes also shifted part of the risk associated with the retirement plan from the employer to the employee.

ASRS reformed pensions for new hires starting as of July 1, 2011, that reduces pension, increases age/service requirement, and reduces the cost-of-living adjustment. The modifications included 1) lengthening the period used to calculate final average salary from 3 to 5 years, 2) eliminating employer contribution refunds for most members who terminate from ASRS and choose to withdraw their account balance, 3) increasing the age and service requirements for normal retirement and 4) eliminating the Permanent Benefit Increase (PBI) which provided a cost-of-living adjustment when investment returns exceeded the actuarially assumed rate.

PSPRS reformed pensions for new hires starting as of January 1, 2012, that increases employee contributions, reduces pension, increases age/service requirement, and reduces cost-of-living adjustment. The modifications included 1) increasing required employee contributions, 2) requiring participating employers to make contributions on behalf of retirees who return to work after retirement, 3) lengthening the period used to calculate final average salary from 3 to 5 years, 4) increasing the service requirement to qualify for normal retirement, and 4) reducing the PBI which provided a cost-of-living adjustment when investment returns exceeded the actuarially assumed rate for those who retire after August 1, 2011. In 2016, Arizona voters approved additional public employee pension reforms for PSPRS.

Going forward, more stakeholders of public pensions will be more alert to the events that impact revenue sources and pension costs associated with their retirement plan.

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Are You Violating Bond Disclosure Requirements?

By Brian Hemmerle, CPA, CFE

Many of you know that some of your governmental bonds are publicly traded, and hence regulated by the SEC. You may also be aware that each municipal bond offering is required to continually disclose certain information on the Electronic Municipal Market Access (EMMA) for each CUSIP that is publicly traded based on SEC Rule 15c2-12. In our Spring 2016 issue, we discussed a single violation of this SEC Rule with the City of Harrisburg. If you thought this violation was an isolated event, think again.

In August 2016, the SEC released the names of 71 governments that violated their continuing disclosure requirements with their municipal bond offerings. None of those governments were from Arizona. You can find the list of governments that violated their requirements and the press release at:

https://www.sec.gov/news/pressrelease/2016-166.html

These governments subsequently settled with the SEC for the violations, and have since implemented appropriate policies, procedures and training regarding continuing disclosure obligations. The most common violation occurred when governments issuing new debt forgot to disclose they had been late in making disclosures on older debt.

Continuing disclosures are used by investors to make sound investment decisions related to your bond offerings. Have you and your finance department prepared policies and procedures for properly disclosing material events and financial statements as required? If not, you will want to enlist the help of your bond council, underwriters and/or financial advisors to detail out what should be disclosed each year, and implement those procedures from which they will be done. You can find the required disclosures in your Continuing Disclosure Agreement (CDA), also sometimes called a continuing disclosure certificate or undertaking. These are included in each bond offering you have issued. To maintain good controls, you should consider having one individual in your finance department gather and prepare the disclosures and a separate individual review and post those disclosures to EMMA. This will help reduce the chance of material misstatements in your disclosures. We discussed in our Spring 2016 article resources you can use for help, such as the GFOA best practices article found at:

http://www.gfoa.org/understanding-your-continuing-disclosure-responsibilities-0

This article will help you to understand the types of disclosure requirements and the policies and procedures you should have in place to properly make your disclosures. In addition to your CDA, there are disclosures that are required if they occur during the year, such as payment delinquencies, bond calls, defeasances and rating changes to name a few. You can also provide voluntary financial information to investors at your discrepancy. Your auditors will be looking at your continuing disclosures every year, to make sure you are complying with the requirements. The SEC is paying more attention now than ever to these municipal bond offerings and their disclosures. It is important that you comply with these requirements and not become a headline in the paper, or see your government on a list of violators issued by the SEC. Finance and management need to take the time to discuss what is required and document the policies and procedures you develop.

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