

Government Finance Officers Association

(www.gfoa.org)

Committee on Retirement and Benefits Administration (CORBA)

BEST PRACTICES

A GFOA best practice identifies specific policies and procedures as contributing to improved government management. It aims to promote and facilitate positive change rather than merely to codify current accepted practice. Partial implementation is encouraged as progress toward a recognized goal.

[Asset Allocation - Guidance for Defined Benefit Plans](#) (1999 and 2009)

[Asset Allocation - Guidance for Defined Contribution Plans](#) (1999 and 2009)

[Communicating Health-Care Benefits to Employees and Retirees](#) (2009)

[Considerations for Prefunding OPEB Obligations](#) (2008)

[Developing a Policy to Participate in Securities Litigation Class Actions](#) (2006)

[Developing a Policy for Retirement Plan Design Options](#) (1999, 2007)

[Endorsing A Framework for Understanding Pension Fund Risk](#) (2001)

[Ensuring the Sustainability of Other Postemployment Benefits](#) (2007)

[Essential Design Elements of Defined Benefit Retirement Plans](#) (2008)

[Essential Design Elements of Defined Contribution Plans as the Primary Retirement Plan](#) (2008)

[Essential Design Elements of Hybrid Retirement Plans](#) (2008)

[Health Care Cost Containment](#) (2004)

[Investment Policies Governing Assets in a Deferred Compensation Plan](#) (2004)

[See checklist](#)

[Monitoring and Disclosure of Fees for Defined Contribution \(DC\) Plans](#) (2008)

[Participant Education - Guidance for Defined Contribution Plans](#) (2009)

[Pension Investment Policies](#) (2003)

[See checklist](#)

[Public Employee Retirement System Investments](#) (1993, 1995, 1997 and 2009)

[Retirement and Financial Planning Services](#) (1998, 2003)

[Strategic Health-Care Plan Design](#) (2009)

[Sustainable Funding Practices of Defined Benefit Pension Plans](#) (1994, 2005, 2008 and 2009)

[Web Site Presentation of Official Financial Documents](#) (2009)

[Governance of Public Employee Retirement Systems](#) (2010)

[Preparing an Effective Summary Plan Description for Retirement Plans](#) (1996, 2010)

[Developing a Review Process for Implementing National Health-Care Reform](#) (2011)

new

[Designing and Implementing Sustainable Pension Benefit Tiers](#) (2011) new

BEST PRACTICE

Sustainable Funding Practices of Defined Benefit Pension Plans (1994, 2005, 2008 and 2009) (CORBA)

Background. The fundamental financial objective of a public employee defined benefit (DB) pension plan is to fund the long-term cost of benefits promised to the plan participants. It is widely acknowledged that the appropriate way to attain reasonable assurance that pension benefits will remain sustainable is for a government to accumulate resources for future benefit payments in a systematic and disciplined manner during the active service life of the benefitting employees.

Long-term funding is accomplished through contributions from the employer and employee, and from investment earnings, which typically provide the largest component of funding. Contributions are often expressed as a percentage of active member payroll, which should remain approximately level from one year to the next. Principles of accrual accounting require that the total cost of employee services be recognized in the period in which those services are rendered. A plan's funding policy codifies the pension system's commitment to fund benefit promises based on regular actuarial valuations. Creating a funding policy that embodies these accounting and funding principles is a prudent governance practice and helps achieve intergenerational equity among those who are called on to financially support the plan, thereby avoiding the transfer of costs to future generations.

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local government officials ensure that the costs of the benefits promised in public employee DB plans are properly measured and reported, in accordance with generally accepted accounting principles (GAAP).¹ The GFOA believes sustainability requires that governments that sponsor or participate in a defined benefit pension plan contribute the full amount of their actuarially determined annual required contribution (ARC) each year. Failing to fund the ARC during recessionary periods impairs investment returns by depriving the fund of its opportunity to invest when stock prices are low. Long-term investment performance will suffer and ultimately require higher contributions.

In pursuing these standards and criteria, public officials and retirement system trustees should, at a minimum, adhere to the following best practices:

1. Adopt a funding policy targeting a 100 percent or more funded ratio (full funding). The funding policy should provide for a stable amortization period over time⁽²⁾, with parameters provided for making changes that are based on specific circumstances. Establish a period for amortization of unfunded actuarial accrued liabilities that does not exceed the parameters established by GAAP⁽³⁾ and that is consistent with the funding policy of the plan.

2. Discuss the funding and amortization methods with your actuary, and select the one that most closely aligns with the funding policy. The actuarial funding method selected is a key component of the funding policy of the plan(4). Some funding methods may result in more variations in the ARC (the portion of the present value of projected benefits that is attributable to the current period) than others. Governments should take measures to reduce the volatility in the ARC in order to create a more predictable operating budget and enhance their ability to meet funding obligations.

3. The funding policy should stipulate that employer and employee contributions are to be made at regular intervals, with the contribution amount determined by the results of a recent actuarial valuation of the system. To ensure that this objective can be achieved, the funding policy should be integrated with investment and asset allocation policies. Reductions or postponements in collecting the ARC would typically be inconsistent with the assumptions made in computing the ARC. When contributions fall below the ARC, the board of trustees should prepare a report that analyzes what effect the underfunding has on the system and distribute the report to all stakeholders.

4. Have an actuarial valuation prepared at least biennially by a qualified actuary in accordance with generally accepted actuarial principles applied in a manner consistent with GAAP. Each valuation should include a gain/loss analysis that identifies the magnitude of actuarial gains and losses, based on variations between actual and assumed experience for each major assumption. Have a comprehensive audit of the plan's actuarial valuations performed by an independent actuary at least once every five to eight years. The purpose of such a review is to provide an independent critique of the reasonableness of the actuarial methods and assumptions in use and the validity of the resulting actuarially computed contributions and liabilities.

5. Actuarial assumptions should be carefully reviewed by retirement system staff, discussed with outside experts (including investment advisors), and explicitly approved by trustees. Assumptions that should be carefully reviewed include the long-term return on assets, salary growth, inflation, mortality tables, age eligibility, and any anticipated changes in the covered population of plan participants. Have an actuarial experience study performed at least once every five years, and update actuarial assumptions as needed.

6. Prepare and widely distribute a comprehensive annual financial report (CAFR) covering retirement system activity, and distribute summary information to all plan participants. The CAFR should be prepared following the guidance provided by the GFOA for the preparation of a public employee retirement system CAFR.

GFOA recommends the following options to reduce ARC volatility:

1. *Smoothing returns on assets.* Smoothing investment returns over several years recognizes that the system's investment portfolio performance does fluctuate, and only by coincidence will it exactly equal the assumed actuarial rate of return for any given year. This approach reduces the volatility within the calculation of the ARC. A smoothing

period is used to balance the need for a longer-term investment horizon with the short-term market fluctuations in the value of plan assets. While the smoothing period is typically about five years, it can be longer, if controls are in place to assure that any variation between the market value and actuarial value of assets does not become too large. A common approach is to establish corridors around market value of assets to stipulate the maximum percentage by which the actuarially smoothed value will be allowed to deviate from the actual market value (pension funds commonly limit the actuarial value of assets to no less than 80 percent of market value and no more than 120 percent). Once a smoothing method is established, the retirement board should adhere to it and avoid making arbitrary changes to the methodology.

2. Diversifying the investment portfolio to reduce volatility in investment returns.

Diversifying assets across and within asset classes is a fundamental risk management tool that also has the effect of reducing the fluctuations in ARC volatility. Although annual changes in the ARC are affected by numerous factors, the most significant is usually investment return. It is recommended that retirement systems periodically conduct asset-liability studies for use in reviewing their asset allocation policies. (See GFOA's Best Practice, Asset Allocation Guidance for Defined Benefit Plans, 2009).

3. Managing investment returns long term. Because the investment return assumption is an average long term expected rate of return, excess earnings in any one year will likely be offset by lower-than-expected rates of return in a future year. Thus, any program that is derived from an excess-earnings concept is detrimental to the funded status of the plan.

4. Managing growth in liabilities. Managing growth in liabilities should also be done long term. All benefit increases for members and beneficiaries should be carefully considered and appropriately approved, and be consistent with all Internal Revenue Service requirements. Whether cost of living adjustments (COLAs), benefit formula enhancements, or post-retirement benefit increases, a clear strategy should be developed that integrates benefit enhancements with the funding policy of the plan. Further, all benefit enhancements and COLAs should be actuarially valued and presented to the Board of Trustees, plan sponsor and appropriate legislative body before they are adopted so the effect of the benefit enhancements on the fund's actuarial accrued liability, funded ratio, and contribution rates is fully understood. This step will help ensure that the goal of fully funding member benefits is achieved, and the financial condition of the retirement system remains sustainable. If a benefit enhancement is being considered, a source of funding should be identified that can support the enhancement over the long term.

5. Maintaining vigilance against ethical violations and benefit calculation abuse. While affecting only a small percentage of retirement systems, and often only in select instances in these systems, headline grabbing abuses of retirement benefit enhancements such as salary spiking can create negative public perceptions that are harmful to all retirement systems and can adversely affect the sustainability of the system. Policies to safeguard against these abuses or undesired outcomes should be considered.

Resources.

- *Financing Retirement System Benefits*, Richard G. Roeder, GFOA, 1987.
- *Pension Accounting and Reporting, Second Edition*, William R. Schwartz, GFOA, 1995.
- *Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report*, Stephen Gauthier, GFOA, 1996.
- *An Elected Officials Guide to Public Retirement Plans*, Cathie G. Eitelberg, GFOA, 1997.
- *A Guide for Selecting Pension Actuarial Consultants: Writing RFPs and Evaluating Proposals*, Robert Pam, GFOA, 1999.
- *Public Pension Systems – Operational Risks of Defined Benefit and Related Plans and Controls Investment Policy Checklist for Pension Fund Assets*, GFOA, May 2003.
- GFOA Best Practice, Asset Allocation Guidance for Defined Benefit Plans, 2009.

Approved by the GFOA's Executive Board, October, 2009.

1 The Governmental Accounting Standards Board (GASB) currently sets GAAP for state and local governments.

2 Public officials and retirement system trustees should exercise extreme caution when considering the use of "open amortization" since this method can delay full amortization indefinitely, and could even result in the amount to be amortized increasing rather than decreasing.

3 GASB standards set a maximum amortization period of no longer than 30 years.

4 The use of projected unit credit method (one of six actuarial cost allocation methods permitted by GAAP) typically would not be consistent with the goal of level funding.

Certificate of Achievement for Excellence in Financial Reporting Program (CAFR Program)

The GFOA established the Certificate of Achievement for Excellence in Financial Reporting Program (CAFR Program) in 1945 to encourage and assist state and local governments to go beyond the minimum requirements of generally accepted accounting principles to prepare comprehensive annual financial reports that evidence the spirit of transparency and full disclosure and then to recognize individual governments that succeed in achieving that goal.



Reports submitted to the CAFR program are reviewed by selected members of the GFOA professional staff and the GFOA Special Review Committee (SRC), which comprises individuals with expertise in public-sector financial reporting and includes financial statement preparers, independent auditors, academics, and other finance professionals.

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Oklahoma Public Employees Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2010

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A stylized, handwritten signature in black ink.

President

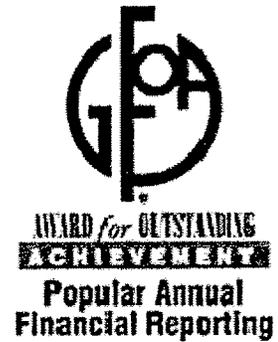
A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director

Popular Annual Financial Reporting Award Program (PAFR Program)

The GFOA established the Popular Annual Financial Reporting Awards Program (PAFR Program) in 1991 to encourage and assist state and local governments to extract information from their comprehensive annual financial report to produce high quality popular annual financial reports specifically designed to be readily accessible and easily understandable to the general public and other interested parties without a background in public finance and then to recognize individual governments that are successful in achieving that goal.

Popular annual financial reports submitted to the PAFR Program are reviewed by selected members of the GFOA professional staff and by outside reviewers with experience in governmental accounting and financial reporting.



**Award for
Outstanding
Achievement in
Popular Annual
Financial Reporting**

PRESENTED TO

**Oklahoma Public
Employees Retirement System**

for the Fiscal Year Ended

June 30, 2010



Linda C. Dawson
President

Jeffrey L. Esser
Executive Director

Public Pension Coordinating Council

Public Pension System Standards 2011

Administrative Standards Assessment

1) Comprehensive Benefit Program

Plans must provide:

- a. Retirement Benefits based on service
- b. In-service death benefits of at least the return of employee contributions or a comparable benefit
- c. Disability benefits for all members provided by either the plan, by Social Security, or by all employers.
- d. The Plan provides for vesting of all accrued plan benefits and prohibits involuntary forfeiture or reduction of all accrued vested benefits.
- e. A post-retirement adjustment of retirement and disability benefits (e.g., COLA) "may" be awarded to retired members by a governmental authority including the governing board, Legislature or other authority. It is not required that the adjustment is automatic or mandatory – it may be discretionary.

2) Audit

The system must obtain an independent audit in accordance with auditing standards generally accepted in the United States of America. The audit was in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. The plan received an unqualified opinion from the auditor on the system's financial statements and on the reports on internal controls and is in compliance with applicable laws and regulations.

3) Actuarial Valuation

- a. An Actuarial Valuation must be performed at least every two years.
- b. Actuary certifies that the valuation was performed using generally recognized and accepted actuarial principles and practices consistent with pronouncements of the Actuarial Standards Board. The report meets the Code of Professional Conduct and Qualifications Standards for Public Statements of Actuarial Opinion issued by the American Academy of Actuaries.

***Receipt of the GFOA Certificate of Achievement for Excellence in Financial Reporting will fulfill the requirements of items 2 and 3 a) & b) above.**

- c. An actuarial review has been performed by an outside, third party actuary, including a replication of the system valuation and an opinion on actuarial assumptions, within the last ten (10) years.

4) Investments

- a. The Board or governing body must adopt and follow written investment policies.
- b. The governing body, retirement board, investment board or legislative body must adopted written fiduciary standards.
- c. The Plan must obtain annual investment performance evaluation from an outside independent investment review entity.

5) Communications

- a. The system must either 1) provide members a handbook or summary plan description at time of employment, or 2) provides a "welcome letter" or similar notification informing new members that a handbook or summary plan description is available online. Updates to the document must be published on a regular basis. Updates to the handbook can be provided regularly on the system's website as long the member is made aware of the updates and may request and receive a hard copy.
- b. Members must be provided with an annual benefit statement.
- c. Meetings of the governing board of the system are conducted at least quarterly with adequate public notice.

Funding Standard Assessment

Funding Adequacy

In order to demonstrate the funding adequacy of the system, the most recent system actuarial report in compliance with GASB Statement 25 must show one of the following:

- 1) at least 100% Funded Ratio, or
- 2) actual contribution rates are at a level equal to or greater than 100% of the Annual Required Contributions (ARC), or
- 3) a plan has been approved by the governing body to achieve 1) or 2) above within 5 years.

This document was prepared by OPERS staff by distilling the 2011 Standards Questionnaire. It is not a publication of the PPCC.



Public Pension Coordinating Council

***Public Pension Standards Award
For Funding and Administration
2011***

Presented to

Oklahoma Public Employees Retirement System

In recognition of meeting professional standards for
plan funding and administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script that reads "Alan H. Winkle".

Alan H. Winkle
Program Administrator